

Findings and
Recommendations

Connecticut's Tax System

Adopted January 19, 2006

Legislative Program Review
& Investigations Committee

Introduction

Connecticut's Tax System

The Legislative Program Review and Investigations Committee initiated a study of Connecticut's state and local tax structure, incorporating an examination of all major state taxes as well as the local property tax, in March 2005. The study was intended to assess the performance of Connecticut's revenue system based on nationally recognized criteria. The nine principles for a high quality revenue system developed by the National Conference of State Legislatures (NCSL) were selected as the primary evaluation framework for the committee's analysis.¹

The study's main purpose was to determine how Connecticut's state and local revenue system "stacks up" in terms of the NCSL principles as well as other relevant national measures and the experiences of comparable states. The committee's briefing report provided a broad assessment of Connecticut's tax system and its major component parts using the nine principles. Based on the information presented in this report and the briefing document, Connecticut's state and local tax system seems to perform fairly well in terms of most of the criteria encompassed by the NCSL principles and in comparison to other states.

Connecticut's system employs a relatively simple yet complementary structure with few layers, and no overlap or duplication. The state imposes a single state sales tax, a single state income tax with no county taxation, and local taxation limited to the tax on property. For the most part, the tax system has provided a reliable revenue stream, outpacing inflation and state economic measures like growth in personal income and gross state product.

As the briefing report indicated, the local property tax provides a great measure of stability to the overall revenue system, but heavy reliance on that tax raises concerns about the balance of Connecticut's state and local tax structure. The briefing report indicated that Connecticut relies more on the property tax than 42 other states, and that three of the remaining states do not have a personal income tax.

Connecticut's personal income tax is relatively simple, with only two rates, high filing thresholds, and few credits and exemptions, but it is only slightly progressive, and does not appear to offset the regressivity of the other taxes on lower- and middle-income groups. However, because the committee had limited access to Connecticut-specific data, no analysis could be done of how the state's tax structure impacts different individuals or households by income levels. For that assessment, the committee had to rely on work conducted by a national research organization using sample data from each state.²

The committee also found problems with the corporate income tax, including questionable compliance and overall declines in revenues. Further, legislative efforts at spurring

¹ National Conference of State Legislatures, *Principles of a High Quality State Revenue System*, December 2002.

² The Institute on Taxation and Economic Policy, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*, 2nd Edition, January 2003.

economic development through tax credits and incentives appear to have little positive effect on job growth or in enhancing the state's competitive position. However, only very limited aspects of the corporate tax and other business taxes credits and their impact on the state's economic growth could be evaluated because of DRS data access issues.

The committee was directed to examine specific states that had implemented tax and expenditure limitations (TELs) and assess what their experiences had been. The briefing report discussed the results in California, Colorado, Massachusetts, Michigan, New Hampshire, and New Jersey. In summary, it is difficult to declare TELs a success or condemn them as a failure. Instead, the impacts vary depending on a variety of elements -- factors included in formula limits, methods for approval, requirements for passing revenue or spending increases, and treatment of surpluses. Imposing strict TELs, like a cap on property tax, is certainly a viable policy option. However, based on the experiences in these states, policymakers should recognize there are both intended and unintended consequences.

In addressing Connecticut's system using the NCSL principles, the scope approved by the committee envisioned that the second phase of the study could present various alternatives for change depending on shortcomings identified in Connecticut's tax system, but that any proposed policy options overall should be revenue-neutral. The committee has maintained that focus in presenting broad policy options in this report rather than specific recommendations for tax reforms. The committee has also attempted to outline some of the major implications of adopting any option but only in a general sense, as it is difficult to predict with any certainty how various taxpayers will be affected or the impacts without extensive data and analysis.

Report Organization. This report has two main sections. The first presents the committee's findings on how Connecticut's system measures up on criteria related to each of the nine principles. Broad policy options the legislature could consider as ways to improve the performance of the state and local revenue structure in terms of one or more principles are also discussed. The first section also includes several recommendations intended mainly to strengthen tax administration, compliance, and future legislative oversight.

Section II outlines the primary tax administration functions carried out at the state level by the Department of Revenue Services, which address the principle of "fair and efficient tax administration". The information provided gives an overview of the current status of the agency's major resources and activities and some general workload trends, but should not be considered the result of a comprehensive performance audit of DRS.

Assessment of Tax Principles

This section describes each of the National Conference of State Legislatures (NCSL) principles and summarizes major committee findings about the performance of the state and local tax system based on an assessment of the various criteria encompassed by the nine NCSL principles for a high quality revenue system. The principles include: Complementary, Balanced, Reliable, Equitable, Economic Development, Promotes Compliance, Accountable and Fairly Administered.

When committee findings indicate a deficiency in the tax structure meeting a principle, the committee presents broad policy options. These options are offered for further consideration by the full legislature as ways that could improve performance of various aspects of Connecticut's revenue structure. However, it must be remembered that improvements intended to achieve better performance on one principle could diminish the system's ability to meet the goals of the other principles. These policy options and their possible implications, if implemented, are also described below. In a number of areas, operational changes intended to strengthen administrative aspects of the system are recommended.

I. Principle: Complementary

Objectives of the tax system should be consistent and the system must recognize limitations and responsibilities of local government.

Findings:

Connecticut has a complementary system, with no overlap in taxing authority, but policymakers do not have an accounting of the cost impact of state mandates on towns, and the state does not fully fund its obligations to municipalities.

- The state's tax structure contains no significant overlap in state and municipal tax bases.
 - Primary revenue sources for state government include income and sales taxes, but not the property tax.
 - Local government revenue-raising authority is limited to the property tax, representing over 98 percent of all local taxes, but municipalities have no legal constraints on levels of taxing property or levels of spending.
- There is no formal recognition of the total cost of state mandates on municipalities.

- Individual fiscal impacts of proposed mandates on municipalities are noted during the legislative process in fiscal notes, but there has never been a full accounting of the cost of state mandates.
- In November 2005, the governor established a commission “to study whether unfunded and partially funded mandates serve an actual need or if they can be curtailed or eliminated.”³ A similar legislative proposal died in committee during the 2005 legislative session.
- As required under statute, in 2002, the Advisory Commission on Intergovernmental Relations (ACIR) identified state mandates and characterized the cost of each as being – significant, moderate, or minor -- though a total cost of mandates was not developed. ACIR is required to publish a complete compendium on mandates every four years and compile an annual supplement in the intervening years.

Recommendation:

- 1. Amend C.G.S. Section 2-79a to require the Connecticut Advisory Commission on Intergovernmental Relations to identify and describe each unfunded and partially funded state mandate affecting municipalities, quantify the actual cost of major mandates, and determine the effect of eliminating or reducing any such mandates. ACIR shall submit a report to the legislature every four years.**
- The state does not fully fund grants to municipalities, notably in the education area and the payment in lieu of taxes (PILOT) reimbursements, or reimburse for other mandated exemptions to the property tax.
 - Not all grant programs, even when fully funded according to statutory formulas, are intended to reimburse municipalities for their entire loss of revenue due to state-mandated exemptions. For example, the grant to reimburse municipalities for state-owned property provides a reimbursement of only 45 percent of the property tax loss for most state property. Consequently, municipalities receive less than they would if the exemptions did not apply.
 - It is estimated for FY 06 that the state has underfunded major statutory grant programs by about \$177 million. (See Appendix A for more detail).

³ November 27, 2005, Press Release on behalf of Governor M. Jodi Rell, *Governor Rell Announces Formation of Commission on Unfunded Mandates*.

- Scientific, educational, literary, historical, recreational, religious, and other charitable nonprofit institutions are exempt through state statute from paying the property tax. Except for certain colleges and hospitals, the state does not reimburse municipalities for this loss of taxes. These institutions combined have property valued at over \$6 billion and represent 16 percent of all exemptions.
- According to the latest U.S. Census Bureau report (2003) that compares state support for funding elementary and secondary public school education, the state of Connecticut ranks among the lowest (47th) in the nation. The national average for state funding of education is 49 percent, while Connecticut contributes 36 percent. This figure includes state support of school construction, debt service, and payments to the retirement system on behalf of local schools. The governor has recently appointed a Commission on Education Finance to examine and develop possible revisions to Connecticut's Education Cost Sharing (ECS) formula.

POLICY OPTIONS: COMPLEMENTARY	
Option Description	Implications
<p>A. Increase State Grant Funding</p> <p>Increase state grant funding to recognize the limitations of municipal revenue capacity relative to municipal responsibilities and to relieve the property tax burden.</p> <p>Specifically: i) fully funding the current Education Cost Sharing grant; ii) fully fund formula grants, including PILOT; and iii) increase the statutory percentage of reimbursement for PILOT to better reflect the amount of revenue lost.</p>	<ul style="list-style-type: none"> • Additional state funds for this purpose would be required and could mean cuts to other areas of spending, revenue increases, and revisions to the spending cap or revenue earmarking (that is set aside the revenue for a particular purpose). The shortfall in funding for major formula grants for FY 2006 is about \$177 million. As discussed above, the statutory formula for the state PILOT program is not intended to fully reimburse municipalities. If the assessment on state-owned property was funded at 100 percent of what was owed to municipalities, they would receive an additional \$118 million. • Total state spending is already very close to permitted levels. Within two years there will be no room under the cap for any increases in local aid unless resources are reallocated (e.g., cuts are made to

POLICY OPTIONS: COMPLEMENTARY	
Option Description	Implications
	<p>other programs) or changes are made to the spending cap.</p> <ul style="list-style-type: none"> • Current forecasts show state revenue shortfalls beginning in FY 08. (Projected revenues will not keep up with current services spending levels or even the lower levels allowed by the cap.)
<p>B. Remove Barriers to Increased State Grants</p> <p>Avoid spending cap restrictions on increased state grants to municipalities by either: i) revising the calculation of the spending cap or ii) earmarking revenues.</p> <p>Capital gains are a significant component of income in Connecticut. The spending cap could be revised to better reflect the state's ability to pay for public services by including capital gains in the cap's definition of personal income. Adding a capital gains factor would make the personal income measure more accurate and possibly lift the allowed rate of increase in annual appropriations.</p> <p>Spending cap issues can also be avoided by earmarking revenues. Funding earmarked from a particular source for a specific purpose is not annually appropriated and, therefore, is not subject to the spending cap.</p>	<ul style="list-style-type: none"> • Providing more state aid to towns could ease reliance on local property tax revenues and achieve better balance among the main components of the state and local tax system. • Higher allowed state spending levels would permit increases in state aid to towns for mandated programs, but it could be difficult to ensure the new funding is restricted to that purpose at either the state or local level. • Instituting a less "conservative" spending cap might be viewed as a broken promise by those who supported the 1991 budget reforms. • Revisions of spending cap provisions would require statutory and possibly constitutional changes. • Earmarking revenues can ensure new state funding is used for intended purposes, but it is not a practice generally endorsed by fiscal policy experts. It limits flexibility in the use of financial resources and puts decision making outside the appropriations process.

POLICY OPTIONS: COMPLEMENTARY	
Option Description	Implications
	<ul style="list-style-type: none"> State revenue shortfalls projected within next five years will likely limit how much new state aid can be provided to municipalities by any mechanism.
<p>C. Review Nonprofit Tax Exemptions</p> <p>Require the Office of Policy and Management or a special task force to examine the issue of property tax exemptions for private institutions holding tax-exempt properties, except those institutions already reimbursed by the state (i.e., certain private colleges and hospitals).</p> <p>The focus of the review would be to determine the extent to which these exemptions are limiting the towns' ability to raise revenue through the property tax, and would also compare state tax policies and municipal approaches to the issue in Connecticut to those of other states and cities.</p> <p>In addition, the study would also explore and develop possible policy options for increasing revenue, such as methods to require or encourage institutions of a certain size or with large endowments to provide PILOT payments to municipalities, as well as an expansion of the state PILOT program to include additional reimbursements to municipalities for exemptions claimed by nonprofit organizations.</p>	<ul style="list-style-type: none"> Nonprofits provide services that either replace or supplement what would be provided by government, so they should not be taxed. Nonprofits, though, benefit from services that they do not pay for, and other taxpayers are forced to subsidize them. If taxed, services provided by nonprofits may have to be cut back or eliminated, and government may have to replace the services at taxpayer expense. Nonprofits may engage in activities that compete with local businesses and, therefore, get a competitive advantage by not paying taxes. Nonprofits constitute an important part of the local economy (e.g., salaries, wages, capital expenditures), and many contribute to the desirability of an area. Taxing nonprofits may impair their ability to make such financial contributions. It is argued that some organizations have gone beyond the original intention of a nonprofit entity, amassing large endowments and with larger nonprofits compensating executives with relatively generous salaries and benefits, indicating that these organizations may have resources to defray the cost of municipal services.

II. Principle: Balanced

A high quality revenue system relies on a diverse and balanced range of sources that tend to mitigate the weaknesses of each individual tax. The major taxes (personal income, sales, and property) should be contributing a nearly equal proportion to total revenues.

Findings:

By most measures, Connecticut is heavily reliant on the property tax and therefore, the state's revenue structure does not meet the principle of a balanced tax system.

- Connecticut levies all the major taxes, but the system is most reliant on the personal income and the property tax, which when combined amount to over two-thirds of total state and local revenue.
 - The property tax, providing about 40 percent of total tax revenues, is the major contributor to the state and local tax system. The personal income tax contributes about 27 percent, while the sales tax adds approximately 19 percent to the total.
- Connecticut's revenue system is more reliant on the property tax than 42 other states and three of the states that are more reliant do not impose a broad based income tax.
 - In Connecticut, like all states in the Northeast region except New York, property taxes account for a higher portion of total state and local tax revenues than the national average of 31 percent.
 - Of the eight Northeast states (New England, New York and New Jersey), two -- Massachusetts and New York -- rely less than Connecticut on property taxes as a proportion of total tax revenues, but they rely more on the individual income tax.
 - When comparing property taxes paid on a per capita basis, Connecticut (\$1,760) ranks second highest in the nation and 77 percent above the national average (\$992).
 - When comparing property taxes paid as a percentage of personal income, Connecticut ranks seventh highest in the nation at 4.1 percent, which is 32 percent above the national average of 3.1 percent.
 - Connecticut municipalities are the second most dependent in the U.S. on property taxes as a source of tax revenue, representing over 98 percent of all *local* tax collections.

- The statewide business proportion of the property tax base has been declining. Since 1989, the residential portion of the property tax base has increased from 58 percent to 67 percent, while the commercial/industrial/public utility portion of the base has declined from 23 to 16 percent. The personal property component of the property tax base, typically paid by businesses, has also declined from 9 to 7 percent. Motor Vehicles (8 percent) and other (2 percent) make up the balance of the tax base.
- Connecticut's reliance on the sales and corporate income tax has declined considerably during the 1990s.
 - Prior to the implementation of the broad-based personal income tax in Connecticut in 1991, the sales tax represented about 28 percent of total revenues, and the corporate income tax represented about 7 to 9 percent. After implementation of the personal income tax, the sales tax initially declined and then leveled off to about 19 to 20 percent of total revenues, while the corporate income tax has declined to about 3 percent.
- Forty-two states have programs that limit or freeze assessed property values, property tax rates, or total property taxes in order to provide property tax relief.
 - Thirty-one states have tax rate limits, 20 states have caps on increases in assessed property values, 23 have limits on total property taxes, and 11 states have freezes on assessed property values or property taxes. (Some states have a combination of limits).
 - Only eight states, including Connecticut, do not have statewide limits that apply to all property taxpayers or residents.
 - A program review analysis of tax rates for the 104 Connecticut municipalities that implemented a revaluation from 2002 through 2004 shows the average rate increase to be about 7 percent above what it would be if the amount raised from taxes was kept level compared to the year before revaluation. Twenty-six towns, however, experienced double digit increases. See Appendix B for a town-by-town breakdown.

POLICY OPTIONS: BALANCED	
Option Description	Implications
<p>A. Reduce Property Tax Proportion of State and Local Revenues</p> <p>Reduce reliance on the property tax to about 33-35 percent of all tax revenues in a three-to-five year phase-in period. This would effectively shift about \$1.3 billion from the state to municipalities.</p> <p>This could allow the state to achieve the often discussed goal of 50/50 funding for local education. Currently, the state would have to invest an additional \$563 million to meet this goal.</p>	<ul style="list-style-type: none"> • Under this proposal, replacement revenues would have to be found of about \$1.3 billion. • Raising the personal income tax or raising the sales tax to fund this proposal would make the state and local revenue system more volatile. • Because the state has not historically funded its obligations to local government, increased reliance on state funding for local needs may destabilize the local finance structure. • This proposal would probably require at least a time-limited requirement for municipalities to reduce the property tax on a dollar-for-dollar basis. • Unless cuts in state spending can be found, the spending cap may limit the state's ability to implement this option. (See policy option B regarding the spending cap under the Complementary principle.)
<p>B. Increase Local Taxing Authority</p> <p>Expand the taxing authority of local governments to levy an income or sales tax. For example, 31 states allow local governments to levy a local sales tax, and 10 states allow local governments to levy an income tax.</p>	<ul style="list-style-type: none"> • This option would negatively impact the complementary nature and simplicity of the current system, and may lead to taxpayer confusion and resentment. • It may generate competition among municipalities and possibly encourage sprawl.

POLICY OPTIONS: BALANCED	
Option Description	Implications
	<ul style="list-style-type: none"> This would circumvent issues with the spending cap but still allow funding to go to towns.
<p>C. Redistribution of the Sales Tax</p> <p>To assist targeted municipalities in providing property tax relief, earmark 1 percent of the 6 percent sales tax (1/6th of sales tax revenues) to return to one of the following:</p> <p>1) the 10 most distressed municipalities, based on quantitative physical and economic distress thresholds defined in C.G.S. § 32-9p(b). Currently, these towns would be:</p> <ul style="list-style-type: none"> – Hartford – New Haven – New Britain – Waterbury – Bridgeport – East Hartford – East Haven – Winchester – Meriden – New London <p>2) the 10 towns whose businesses generate the most sales tax revenue:</p> <ul style="list-style-type: none"> – New Haven – Hartford – Stamford – Danbury – Norwalk – Manchester – North Haven – Greenwich 	<ul style="list-style-type: none"> Would have to find replacement revenue for the state. The towns would not be able to use this funding for any purposes other than to provide property tax relief. Based on OPM's 2005 rankings, the 10 most distressed municipalities would receive approximately \$88.4 million total (using 2002 collections data). The amounts each distressed municipality would receive are included in Appendix C. This option would target towns most in need; however, funding would be limited to a portion of the dollars generated through the state sales tax. See Appendix C for a complete listing of what these 10 towns generated in sales tax collections during 2002. Using DRS' 2002 collections, this option would return a total of approximately \$154.7 million to the municipalities. This option would provide these towns with a total \$154.7 million in property

POLICY OPTIONS: BALANCED	
Option Description	Implications
<ul style="list-style-type: none"> – Bridgeport – Berlin <p>3) the 10 towns generating the most sales tax revenue (minus collections from sales on new and/or used cars);</p> <ul style="list-style-type: none"> – New Haven – Hartford – Danbury – Stamford – Norwalk – North Haven – Manchester – Greenwich – Bridgeport – Berlin <p style="text-align: center;">OR</p> <p>4) A less targeted approach, returning 1 percent of the sales tax revenue to each of the 15 municipal planning regions.</p> <p>This option could be combined with an incentive program to regionalize municipal service delivery to reduce the overall cost of local government.</p>	<p>tax relief.</p> <ul style="list-style-type: none"> • This option, which might encourage sprawl, conflicts with smart growth objectives which try to deter sprawl. • See Appendix C for a complete listing of these 10 towns and their individual collections estimates. • Using DRS' 2002 collections, this option would return a total of approximately \$144.6 million to the municipalities. • This would provide these towns with a cumulative \$144.6 million in property tax relief. • This conflicts with smart growth objectives. • Based on 2002 collections data, the municipal planning regions would receive approximately \$394.3 million total. The amounts for each municipal planning region are provided in Appendix C. The amounts would have to go to towns for property tax relief, but the regional planning groups would decide on how the revenue would be distributed. • This option would be more equitable in that all regions would receive a portion of their sales tax collections and provide no increased incentive for sprawl.

POLICY OPTIONS: BALANCED	
Option Description	Implications
<p>D. Enact Local Tax and Expenditure Limitation (TEL)</p> <p>Require municipalities to limit the growth in the property tax through one or a combination of the following:</p> <ul style="list-style-type: none"> • <i>a tax rate limit</i> - limits overall property tax payment or restricts tax levies; • <i>an assessment limit</i> – restricts how much property values may increase in a year for tax purposes; • <i>a revenue roll back</i> – requires local governments to reduce mill levies when assessments grow by more than a certain percentage; • <i>an expenditure limit</i> – directly restricts the growth in local government spending to a factor such as population and inflation; or • <i>revitalize Connecticut's closed property tax freeze program</i> – reopen the property tax freeze program in Connecticut and expand eligibility. 	<ul style="list-style-type: none"> • This proposal may require more discipline over local budget and tax practices. • These options may require local governments to evaluate programs more formally and prioritize services. • TELs would contain property taxpayer burden over time. • TELs provide certainty, stability, and predictability for property taxpayers. • These proposals would make the system more complicated, and often substitutes one set of inequities for another. • Enactment of a TEL may fail to provide enough revenue to meet continuing levels of service in hard economic times. • These types of limits often fail to account for growth in intensive local government service areas, such as education, and would, therefore, require additional state aid to make up some of the lost revenue. • An increasing reliance on state government to provide funding, while limiting local government flexibility, may diminish local autonomy and destabilize the local finance structure, especially given the state's pattern of underfunding obligations to

POLICY OPTIONS: BALANCED	
Option Description	Implications
	<p>municipalities.</p> <ul style="list-style-type: none"> • Assessment limits can cause disparities between long-time homeowners and new residents. • Assessment caps result in ambiguous subsidies and tax shifting with no clear public purpose or benefit. • Local government service quality in general may be impaired. For example, per-pupil spending and student performance declined in California. • In California, Proposition 13 increased the use of dedicated funding, which is contrary to best practices in fiscal policy. • Municipalities may turn to increasing local fees and other mechanisms that are much more narrow sources of revenue to recover the loss in taxes, which tends to be less equitable and more volatile.
E. See also Policy Option A (Increase State Grant Funding) under the Complementary Principle.	Implications are discussed under the Complementary Principle.

III. Principle: Reliable

Revenues produced by a tax system should be stable, certain, and sufficient. Revenues should be relatively constant and predictable over time and at levels adequate for balancing the budget each year and adapting to desired spending changes.

Findings:

Connecticut's state tax revenues are volatile and some state taxes are prone to frequent revision. Local property tax growth is relatively slow but steady and adds stability to Connecticut's overall revenue structure.

In total, state and local tax revenue growth is well above the rate of inflation and generally keeps pace with growth in the economy. State revenue collections, however, do not always match state spending levels, large General Fund budget shortfalls have occurred during severe economic downturns, and deficits are forecast within the next five years.

- Connecticut state tax revenues are more volatile than the state economy and, like other Northeast states, more volatile than the national average for state revenue systems.
 - State tax collections in Connecticut (adjusted to remove the impact of legislative changes) have higher highs and lower lows over time than growth in state personal income.
 - Actual state revenue growth in Connecticut fluctuates more than for the U.S. on average and for four states in the region -- Maine, New Jersey, New York and Rhode Island. (See Appendix D, Table D-1 for all comparative data.)
 - Much of Connecticut's revenue instability seems related to highly fluctuating state personal income tax collections, which are due primarily to the very volatile incomes of taxpayers in the top brackets.
- The local property tax is the system's least volatile revenue source and provides an important stabilizing effect on Connecticut's overall tax structure. Property taxes are highly predictable, once assessments are finalized, and less sensitive than sales and income taxes to short-term economic changes.
 - However, when revaluations occur, the impact on tax liability can be more significant for some taxpayers than others. It is important to "level out" the impact of revaluations through mill rate reductions.
 - More frequent revaluations lessen the "sticker shock" of large tax increases due to rapidly escalating property values.

- Certainty of the revenue system is somewhat reduced by frequent modifications of Connecticut's corporate income tax including periodic surcharges, continual changes in excise tax rates for motor fuels and cigarettes, and the exemptions added to the sales tax during most legislative sessions. The state personal income tax, however, has undergone little significant revision since its adoption in 1991, and while some changes have been made to the sales tax base, its rate has remained the same since 1992.
- A recent Federal Reserve Bank of Boston report found Connecticut has a high level of "fiscal comfort," meaning relative to other states, it has high revenue capacity and low fiscal need. The state's consistently high bond ratings also reflect sufficient fiscal resources in comparison to expenditure requirements.
 - Among the state's fiscal strengths cited by the major bond rating agencies are its wealth, healthy personal income growth, its reasonable cap on state spending, and its budget reserve ("rainy day") fund.
 - Concerns of the bond agencies include Connecticut's heavy debt load, large unfunded pension liabilities, and use of nonrecurring resources to meet expenditure requirements.
 - Based on recent bond agency reports, Connecticut's ratings would likely move up (from levels that are good to the highest tier) if: high reserve levels were achieved and maintained; a trend of structural budget balance was established; and debt ratios were reduced.⁴
- Since enactment of the state's broad-based income tax in FY 91 through FY 03, state and local revenues together grew a total of nearly 63 percent; while inflation was just under 33 percent, state personal income rose almost 56 percent, and state and local spending increased about 60 percent.
 - Revenue shortfalls, however, still occurred at the state level and Connecticut has been unable to avoid spending cuts and tax hikes that are disruptive to business and individuals and to the management of public programs.
 - The significant volatility of the state revenue stream combined with the severity of the most recent recession contributed to General Fund deficits of more than \$800 million in FY 02 and almost \$100 million in FY 03.
 - The state Budget Reserve Fund, with a required maximum balance of only 5 percent of total appropriated spending before

⁴ In many cases, mismatches between government revenues and expenditures are related to economic cycles but when expected spending continually outpaces expected revenue collections, structural budget problems are indicated. Structural imbalances are chronic gaps that result when the rate of revenue growth fails to keep up with growth rates of the economy and the cost of government at current services levels.

2002, was of limited use in cushioning the effects of Connecticut's substantial revenue shortfalls. (This problem was addressed to some extent by legislation enacted in 2003 that raised the fund balance to 10 percent.)

- Fiscal forecast information presented in November 2005 to the finance and appropriations committees by the legislature's Office of Fiscal Analysis (OFA) and OPM in accordance with P.A. 05-262 shows the state could face budget shortfalls again beginning in FY 08. (See supporting data presented in Appendix D, Table D-2.)
 - Under OPM assumptions for the longer term, state spending at current service levels will exceed projected state revenues by significant amounts each year from FY 08 through FY 10. In each of these years, state expenditures at the current service rates will also exceed the level allowed under the state spending cap.
 - Projected state revenues will not even keep up with the lower, capped spending levels beginning in FY 08.
 - It is estimated Budget Reserve Fund monies would be available to offset possible state deficits in FY 08 and FY 09, but by FY 10 the fund would be depleted. (The state's FY 02 deficit exhausted the fund in one year and it has only recently started to rebuild its balance with deposits of surplus monies from FY 04 and 05.)
 - At its present level, the Budget Reserve Fund balance represents 4.3 percent of appropriated spending and is almost \$808 million short of the 10 percent target. Anticipated surpluses in FY 06 and FY 07 could raise its balance to over 6.2 percent (\$1.12 billion).
- Based on an analysis of OFA expenditure data from FY 00 through FY 05, the major expense categories for the state General Fund are Medicaid, employee compensation and fringe benefits for active and retired employees, education aid, debt service, other agency operating expenses, and human service programs at the Department of Children and Families (DCF) and the Department of Mental Retardation (DMR). (See supporting data presented in Appendix D, Table D-3.)
 - Most of the costs in the General Fund's largest major accounts represent mandatory spending (e.g., required by federal or state law, contracts and agreements, or court order). In each case, growth in these expenditures is greater, sometimes significantly, than growth in General Fund revenues.

- Between FY 00 and FY 05, the average annual increase in total General Fund expenditures was 3.8 percent while General Fund revenues grew on average, 2.7 percent per year.
 - Total growth in Medicaid spending, the largest major account, was almost 30 percent while debt service, the fourth largest major account, increased almost 40 percent. The Retired State Employee Health Services Costs account, which made up about 3 percent of the FY 05 General Fund budget, almost doubled between FY 00 and FY 05 (a nearly 88 percent cumulative increase).
 - When state budgets cuts are necessary, aid to municipalities is often the first expenditure area subject to reduction. Cumulative growth among the major General Fund Accounts was smallest (15.1 percent) in funding for the ECS grant, perhaps indicating the negative impact of state revenue volatility in terms of stable financial support for cities and towns.
- The sources of spending pressure in Connecticut appear similar to those in other states. A recent fiscal survey found rising health care costs to be the single biggest obstacle to states' economic recovery; also, while state revenue growth during the past fiscal year was strong, expenditure pressure is very high.⁵ Programs identified as presenting the largest fiscal challenges to states were: Medicaid, K-12 education, corrections, underfunded pensions, and infrastructure.
 - Connecticut seems to rely heavily on bonding to fund state activities (almost 10 percent of General Fund spending in FY 05 and at 6 percent over the past 10 years), based on comparative data and the amount the state pays in debt service.
 - National studies consistently find Connecticut has one of the highest debt burdens in the U.S. A recent report by Moody's Investment Services on state debt burden shows Connecticut, compared to all states, ranked number one on the measure of per capita debt and number three on the measure of debt as a percent of income.⁶
 - Ten factors that place states at risk for structural budget problems were identified in a recent report by the Center on Budget and Policy Priorities, a national nonprofit policy research group.⁷ Most are associated with tax

⁵ "The Fiscal Survey of the States," National Governors Association and National Association of Budget Officers, December 2005.

⁶ "2005 State Debt Medians," Moody's Investors Services Special Comment, May 2005.

⁷ "Faulty Foundations: State Structural Problems and How to Fix Them," Center on Budget & Policy Priorities, Washington, D.C., August 2005.

structure (e.g., a lack of services in the sales tax base; weaknesses in the corporate income tax; untaxed e-commerce; extensive tax preferences for the elderly; limited personal income tax progressivity; a tax mix that worsens budget gaps), but spending pressures from growing resident needs and other types of fiscal policies (e.g., failure to detach from federal funding requirements, process restrictions like tax and expenditure limits) are also included.

- The report found the majority of states, 44 including Connecticut, face five or more risk factors, and all states faced at least three.
 - Compared to other Northeast states, Connecticut had the same number of structural gap risk factors (six) as New Hampshire and Massachusetts, fewer than Rhode Island (eight), and more than Maine, New York, New Jersey and Vermont (three to five).
 - The report’s main finding, supported by similar analysis by the National Conference of State Legislatures, is gaps in state budgets will persist, and continually require policymakers to cut spending, hike taxes, or both, although modernizing tax structures to capture the full range of growth in the economy might help.
- California, like Connecticut, experiences more dramatic variation in its revenue collections than most states. A study conducted by that state’s nonpartisan Legislative Analyst’s Office (LAO) found two major reasons for California’s revenue volatility are the state’s dynamic economy and its heavy reliance on a highly progressive personal income tax.
 - The LAO report found volatility could be lessened by either revising the state’s basic tax structure (e.g., reducing personal income tax progressivity, rebalancing the tax mix away from the income tax) or managing volatility with budgeting strategies (e.g., building up substantial reserves, allocating a portion of revenue growth during good times to certain one-time purposes like debt reduction) or some combination of both options.
 - LAO concluded the least disruptive and most effective volatility reduction strategy was a large reserve fund.
- Recent research including reports by the Government Finance Officers Association and the Center on Budget and Policy Priorities suggests an adequate level of reserve funding for most states, particularly those with high budget volatility, is at least 15 percent of annual expenditures. Automatic deposit rules along with flexible withdrawal and replenishment policies are other recommended best practices for “rainy day” funds.

- Connecticut’s currently required fund size, 10 percent of General Fund net appropriations, was put in place in 2003 largely in recognition of the inadequacy of the prior maximum balance (5 percent from the time the fund was created in 1978 until 2002 and then 7.5 percent for one year).
 - A 10 percent balance would have been sufficient to cover the last serious deficit (more than \$800 million in FY 02) but may not be adequate for any extended economic downturn.
 - As discussed above, the fund’s current balance is less than 5 percent at present and is unlikely to reach the 10 percent level in the near future. Achieving a 15 percent reserve would take many years given the state’s projected fiscal condition.
 - The state constitution requires any unappropriated General Fund surpluses be transferred first to the state’s budget reserve fund to raise its balance to the maximum required. The fund can only be applied to state operating deficits at the end of a fiscal year but there are no other withdrawal or replenishment requirements.
 - The legislature has a fairly good record in making reserve fund deposits and using surpluses as required (see PRI *Connecticut Budget Process*, 2003). However, surplus funds can be “intercepted” and appropriated for a variety of current budget purposes. In the current fiscal year, some surplus money was used to increase aid to local governments.
 - If all surplus monies from the past two fiscal years had been deposited in the Budget Reserve Fund, the fund would be at its 10 percent target.
- State sales tax revenues have not kept pace with the economy, and growth has been slow; however, these revenues have become less volatile and more predictable in recent years.
 - From FY 90 to FY 04, the cumulative growth in the state’s personal income was 61.8 percent, while actual sales and use revenues grew in total by 42.4 percent and inflation was 43.7 percent.
 - The substantial lag in sales tax revenue growth behind personal income is reflecting what appears to be a nationwide trend that is likely the result of an increasing number of exemptions, a shift away from consumption of taxable tangible goods toward tax-exempt services, and the increased consumer preference for purchasing goods online and tax free.

- One way to address the erosion of the sales tax base is to capture lost revenue from internet and catalog sales by participating in the Streamlined Sales Tax project. At present, Connecticut is not an active participant – meaning it has not signed the Streamlined Sales Tax Agreement or amended its sales tax law to conform to the standardized definitions.
 - The Streamlined Sales Tax Project is a coordinated effort of 40 states (19 full member states) to simplify and modernize sales and use tax administration in order to gain the authority to require businesses, including Internet vendors, to collect sales taxes for each member state.
 - By adopting uniform definitions and eliminating thresholds, the project simplifies the tax laws and improves the efficiency of tax administration.
 - Participating states also significantly reduce the burden of tax collection by implementing new technology that enables businesses to more quickly, easily, and accurately determine what is taxable and at what rate in each state in which they conduct business.

POLICY OPTIONS: RELIABLE	
Option Description	Implications
<p>A. Maintain Stronger Reserves</p> <p>Make building and maintaining the Budget Reserve Fund a priority by depositing all surplus monies until the fund reaches its 10 percent maximum balance.</p> <p>Require OPM in consultation with OFA to conduct an economic analysis of the possible uses of surplus funds to determine the long-term costs and benefits of various alternatives including but not limited to debt reduction, funding pension liabilities, and increasing the BRF balance.</p> <p>Based on the study results, consider increasing the maximum reserve fund size to 15 percent and statutorily requiring the deposit of all surplus monies (not just the unappropriated amount) until the maximum balance is reached.</p>	<ul style="list-style-type: none"> • Adequate, accessible reserves contribute to state revenue stability and good bond ratings; budget stabilization funds allow avoidance of spending cuts and tax hikes when conditions are least favorable for such actions. • The California LAO revenue volatility study showed restructuring the mix of state taxes to improve stability involves significant policy tradeoffs; stability may be gained but adequacy (e.g., less revenue growth) or equity (e.g., increased regressivity) may be diminished. • A reserve balance greater than 10 percent could better handle a serious recessionary period such as ones Connecticut experienced in the early 2000s and the early 1990s; applying all surplus monies to the BRF would build up the balance more

POLICY OPTIONS: RELIABLE	
Option Description	Implications
	<p>quickly during good economic times, placing the state in a better position to handle a fiscal crisis.</p> <ul style="list-style-type: none"> • High level reserve funds require fiscal discipline. This is difficult to legislate and hard to maintain, especially if advocates for programs that were cut or flat funded during downturns question keeping a high reserve balance in “good times” when needs are going unmet. • Given projected fiscal trends, it appears unlikely surplus funds will be available after FY 08 to build or maintain the reserve fund, even at a 10 percent balance. According to bond rating agencies, other states (e.g., Massachusetts) have maintained their reserves despite revenue drop offs by strongly controlling the expenditure side of their budgets. • In their recent fiscal forecasts, both OPM and OFA point out the state may be better off using some portion of surplus funds to reduce long-term financial obligations (such as bonded indebtedness or unfunded pension liabilities) rather than increasing its budget reserves. Conducting an economic analysis would provide policymakers with the information necessary for making the best decisions about surplus use.
<p>B. Improve Sales Tax Reliability</p> <p>1) Broaden the base and lower the rate of the state sales tax to improve its reliability; specifically, reduce the rate to 3.5 percent and eliminate all current exemptions. Do not apply the tax to business purchases.</p> <p style="text-align: center;">OR</p>	<ul style="list-style-type: none"> • According to economists, lowering the rate while broadening the base (eliminating exemptions) would have a neutral effect on the amount of revenue raised by the tax in the short-run; however, over time it would raise more revenue because it would be more responsive to modern consumption patterns.

POLICY OPTIONS: RELIABLE	
Option Description	Implications
2) Broaden the base while maintaining the exemptions that decrease the regressivity of the tax (i.e., food, clothes, prescription drugs, patient care services and utilities for residential use) would make the tax more progressive.	<ul style="list-style-type: none"> • These proposals would still maintain autonomy of sales tax administration at the state level. • Broadening the base may increase the occurrence of pyramiding/cascading, which is when businesses decide to shift the burden of their taxes onto the consumer by raising prices. For this reason economists and business agree that the base should not include business purchases. • Lowering the rate would make the tax more competitive. In 2005, the 3.5 percent suggested rate would be the lowest and simplest single state rate in the country.⁸ • Eliminating exemptions would simplify the administration of the tax for businesses, retailers, consumers, and DRS and therefore promote better compliance. • Broadening the base will increase the transparency and equity of the tax. • Broadening the base will increase the number of merchants requiring sales permits and remitting the tax. • Consumption of services is growing faster than that of goods. From 1945 to 2002 consumption of goods decreased from 67 percent of personal income to 41 percent, and consumption of services rose from 33 to 60 percent of personal income. A broad base would avoid losses resulting from increasing consumption of tax-exempt services.

⁸ Colorado would be the only state with a lower state sales tax rate (2.9%); however, Colorado and the six states taxing at the statewide rate of 4 percent all permit a local sales tax.

POLICY OPTIONS: RELIABLE	
Option Description	Implications
<p>C. Increase Participation in the Streamlined Sales Tax Project</p> <p>Become a full or associate member in the SST project, and capture more e-commerce and mail transactions which will improve the reliability of the state sales tax.</p>	<ul style="list-style-type: none"> • Full SST participation would provide additional revenues and stem the erosion of the sales tax base. • The state still retains its authority to decide what is taxed and at what rate. • Full participation would require the state to eliminate thresholds – SST members cannot tax items at different or partial rates or only above a certain baseline amount (e.g., all clothing would have to be taxed at the full rate, providing an additional \$120 million in revenue, or be completely exempt). • Adopting the uniform definitions will ease administration of the tax for businesses, retailers, consumers, and DRS and, therefore, promote better compliance. • Standardized definitions and more sophisticated technology will ease the complications for business located in other states conducting business, such as sales, in Connecticut. • It will allow the state to gain additional sales tax revenue from those businesses and retailers who choose to participate and potentially from all businesses should federal legislation ultimately pass. (OPM estimates the state is at risk of losing approximately \$440 million in revenue from internet and catalog sales in FY 06.) • Uniform definitions could simplify administration by allowing for sharing of

POLICY OPTIONS: RELIABLE	
Option Description	Implications
	case law decisions (e.g., clarifying how definitions are to be applied in practice).

IV. Principle: Equitable

The overall tax system should minimize regressivity and not place an unfair burden on people with lower incomes.

Findings:

Connecticut's tax system is similar to the rest of the nation in terms of the state's overall tax burden.

- Connecticut's state and local tax burden was 10.2 percent of state personal income in 2002. This was slightly lower than it was in the mid-1990s.
- The national average was the same as Connecticut – 10.2 percent.

PERSONAL INCOME TAX

- Connecticut's personal income tax is mildly progressive, but that does not offset the regressivity of the state's sales, excise and property taxes.
 - The Suits Index, a widely used measure to determine progressivity of taxes, indicates that Connecticut's income tax is mildly progressive. In addition, higher-income earners tend to pay a higher effective income tax rate (the percent of the tax of adjusted gross income).
 - While Connecticut's sales tax appears to take a lower proportion of income from lower- and middle-income taxpayers (6.3 percent) than the national average (7.8 percent), low wage earners still devote a higher percentage of income to sales taxes than the top 20 percent of wage earners (about 1.5 percent) in Connecticut.
- Connecticut's tax system is about in the middle of the Northeastern states in measuring overall equity, but it ranks behind only New Hampshire when burden on the top earners is considered. Connecticut places less burden on the top income group than the U.S. average.
 - Connecticut's top 1 percent pays 6.4 percent of income in taxes, while the U.S. average is 7.3 percent.

- When the federal offset⁹ is considered, the burden in Connecticut is only 4.4 percent versus the national average of 5.2 percent.
- Connecticut places less tax burden on high income earners than any of the other Northeast states except New Hampshire, which has no income tax. As Table I-1 indicates, tax burden in Connecticut takes 6.4 percent of income the top one percent of earners, much less than in New York (9.1 percent) and New Jersey (8.4 percent), and slightly less than Massachusetts (6.8%).

Table I-1. Tax Burden in Low and High Income Groups: A Comparison of Northeast States									
Income Group	CT	MA	ME	VT	NY	NJ	RI	NH	US Avg. (all states)
Lowest 20%	10.3%	9.3%	10%	10%	12.7%	12.5%	13.0%	8.1%	11.4%
Highest 1%	6.4%	6.8%	9.7%	9.7%	9.1%	8.4%	8.6%	2.4%	7.3%
Difference	3.9	2.5	0.3	0.3	3.6	4.1	4.4	5.7	4.1%
Source: Program Review Analysis of ITEP “Who Pays?” Data.									

- Program review committee used the Institute of Taxation and Economic Policy information (also used in the briefing report) to establish an equity measure on how taxes in the Northeast states affect the poorest 20 percent and the top 1 percent. The committee took the percent of income paid in taxes (sales, income and property) by the two income groups and ascertained the difference between the two. The greater the difference, the more inequitable the state tax system, meaning the lowest income group pays a greater share than the highest income group. The results are shown in Table I-1. (See Appendix E for full comparisons among the Northeastern states).
- All of the Northeast states place a greater burden on the lowest-income group than on top income earners. However, Maine and Vermont have the least difference -- 0.3 -- indicating greater equity than other states.
- Connecticut was fifth of the eight states in terms of equity with a difference of 3.9. New Hampshire appears to have the most inequitable tax system, with its lowest income group paying a much higher share (8.1 percent) of income than the top group (2.4 percent). This is largely because the personal income tax is typically one of the most progressive taxes, and New Hampshire has no income tax.

⁹ Federal offset refers to the impact of itemized deductions allowed off federal income taxes for state and local income taxes and property taxes. These deductions tend to benefit higher-income groups, by reducing the amount these groups owe in federal taxes.

- Connecticut ranks second (after New Hampshire) in the low percentage of income paid in taxes by the highest income group (at 6.4 percent) followed closely by Massachusetts (6.8 percent).

POLICY OPTIONS: EQUITABLE	
Option Description	Implications
<p>A. Earned Income Tax Credit</p> <p>Connecticut could adopt an Earned Income Tax Credit (EITC) Program similar to other Northeast states.</p> <p>Establish a piggy-back EITC based on federal EITC and establish it as refundable credit, meaning a filer would receive the amount of the credit, even if it were more than income tax liability.</p> <p>There has been a federal earned income tax credit program in place since 1975. The objective is to offset the burden of payroll taxes, reduce poverty, and provide an incentive to work.</p> <p>Certain states are using the state personal income tax system to reach the same objectives and to relieve the regressive nature of the sales and property tax, and hence make the system more equitable. For example, 28 states use child or dependent care credits depending on income, and 18 states use an earned income tax credit.</p> <p>Of the 18 states with an EITC, all the states in the Northeast have one except New Hampshire and Connecticut have an earned income tax credit. New Hampshire has no income tax.</p> <p>Most states “piggyback” on the federal</p>	<ul style="list-style-type: none"> • If Connecticut were to adopt an earned income tax credit of 20 percent of the federal tax credit it is estimated to cost about \$55 million in 2005.¹⁰ • It is not assured that a state EITC would make Connecticut’s tax system more equitable. New Jersey and New York, which have state EITC programs in place, yet have greater burdens on lowest income groups than Connecticut. • Would provide an incentive for people to work, even if income is low. • Using \$55 million and the same number of CT filers who receive the FEITC would mean an average credit of \$338. • It is unlikely the same number of filers would apply for a CT EITC program as apply for the FEITC (162,541 filers, or almost 10 percent of all CT filers claimed the federal EITC). However, the federal filing requirements are markedly different from Connecticut’s. A single filer under 65 must file a 2004 federal return if his/her income was \$7,950; in Connecticut the filing requirement threshold was \$12,625 for a single person. For those married filing jointly the IRS threshold was

¹⁰ This is based on IRS data for Tax Year 2002 indicating the number of filers from Connecticut and the total dollar amount for the state – 162,541 filers with a credit value of \$251 million. The average value was \$1,545. The program review committee projected an inflation rate of 3 percent per year, using similar increases as the IRS applies to the income eligibility and credit standards for the EITC program (with no change in number of filers). If the proposed Connecticut EITC program used 20 percent of the estimated federal value of \$275 million, it would cost Connecticut about \$55 million (assuming a similar number of filers as file with IRS).

POLICY OPTIONS: EQUITABLE	
Option Description	Implications
<p>earned income tax credit (FEITC), using a percent of that as the state earned income tax credit.</p> <p>The federal income limits for 2005 are \$38,348 for married couple filing jointly with two or more qualifying children. The maximum credit allowed for that family is \$4,400. The FEITC is refundable, meaning a qualifying filer receives that amount even if the tax liability is less than the credit. Some states have a similar refundable provision while other states limit it to a credit of the tax liability.</p> <p>The following states use a variety of percentages of the federal tax credits for the state credit.</p> <ul style="list-style-type: none"> – New Jersey is 20 percent, but income must be less than \$20,000; – New York is 30 percent; – Massachusetts is 15 percent; – Maine is 5 percent; – Rhode Island is 25 percent; and – Vermont is 32 percent. <p>All but Rhode Island and Maine allow for refundable tax credits.</p>	<p>\$16,850, while it was \$24,000 in CT.</p> <ul style="list-style-type: none"> • Thus, given Connecticut's filing thresholds, the state would want to offer a refundable credit otherwise it would not benefit lower-income persons exempt from filing. • An EITC program may be administratively burdensome for the filer to submit a return and DRS to process it for a very small amount of money—average of \$338. • This type of program is prone to error and abuse. The Internal Revenue Service conducted a study of the federal earned income tax credit program and found that 27 to 32 percent of the claims were erroneous. It is likely there would also be a high error rate with a state EITC program, although Connecticut could delay the credit until each filer's federal EITC were approved by IRS.
<p>B. Modify Personal Income Tax Structure</p> <p>1) Modify the Connecticut personal income tax structure by establishing an income tax rate of 5.5 percent (from current 5 percent) for filers with income above \$250,000 Connecticut adjusted gross income.</p>	<ul style="list-style-type: none"> • This would make the state's income tax somewhat more progressive, by adding a third rate for higher-income groups. However, it would also make personal income tax revenues more volatile, with greater increases during good economic times and more significant declines when the economy slows.

POLICY OPTIONS: EQUITABLE	
Option Description	Implications
<p style="text-align: center;">OR</p> <p>2) Modify the Connecticut personal income tax structure by establishing two new rates for higher-income filers-- 5.5 percent from \$150,000 to \$250,000, and 6 percent at \$250,000 and above.</p>	<ul style="list-style-type: none"> Based on 2003 Connecticut income tax data, this option would conservatively raise about \$130.8 million in additional income tax revenue. Based on 2005 revenues collected, a conservative estimate is \$168.4 million in additional revenue. <p>(Assumptions: personal income tax revenue increased over \$931 million between 2003 and 2005. Based on calculations from 2003 filings, 40 percent of taxes paid are by filers at \$250,000 and above. Thus, using these figures, program review committee calculates that, at 2005 collection rates, an additional \$168.4 million in total.)</p>
	<ul style="list-style-type: none"> This would make Connecticut's personal income tax structure more progressive, but again would increase volatility by relying more heavily on revenues from top earners. Based on 2003 filings and using conservative estimates, this option would increase personal income tax revenues about \$306 million. Using increases in collection amounts between 2003 and 2005, and estimating that 50 percent of taxes are paid by filers at \$150,000 and above, this second option should raise a total of \$390 million. Raising the top rates would still keep Connecticut's effective tax rates competitive for top income earners. For example, the first option would raise the effective rate on the top income groups to 4.01 percent – compared to:

POLICY OPTIONS: EQUITABLE	
Option Description	Implications
	<ul style="list-style-type: none"> – Massachusetts at 4.3 percent; – New Jersey at 4.2 percent; and – New York at 5 percent. <ul style="list-style-type: none"> • Further, because of the federal offset for deductions like state and local taxes, and mortgage interest payments, which are especially beneficial to higher-income earners, the effective tax rate is even less. • To keep the system revenue neutral, the additional revenue earned through the income tax could offset the costs of other options adopted (e.g., targeted tax relief programs, adequately funding the state's grant obligations, or the earned income tax credit program).

PROPERTY TAX

Findings:

- Property taxes in Connecticut take a larger share of the incomes of the lower- and moderate-income taxpayers than most other states.
 - ITEP national data show that property taxes accounted for 2.6 percent of the income from low- and middle-income groups nationally; in Connecticut it took 4.1 percent.
 - In the Northeast states, only New Hampshire (4.3 percent) and New Jersey (4.6 percent) took a higher percent from low and middle income groups.
 - Although there is some dispute over how regressive the property tax is, towns with lower per capita income tend to have higher effective property tax rates.
- Current property tax relief programs are limited or are poorly targeted.
 - The property tax freeze program that applies to individuals with annual incomes less than \$6,000 has been suspended since

1979. It has only 910 participants in the program, who were enrolled in the program before it was suspended.
- The circuit breaker program for the elderly and disabled has about 44,000 recipients and cost about \$21 million in FY 04.
 - The property tax credit for the income tax is not well targeted. In 2003, over 940,000 filers claimed credit through this program at a cost of \$272 million. The tax credit does not provide any relief to individuals who are not required to file an income tax return but pay other taxes. Further, fairly high earners are able to take the full credit – for example, a single filer with CT AGI up to \$55,000 gets full credit. A married couple filing jointly gets full credit if CT AGI is \$100,500 or less.
 - Municipal governments have the option to provide a number of abatements or exemptions to certain individuals. Municipalities, for example, may abate the property taxes due to an owner-occupied residential dwelling to the extent the taxes exceed 8 percent of the taxpayer's income. Tax relief provided under these provisions is not reimbursed by the state.
 - Reverse mortgages are available to the elderly to turn property equity to an income stream that can help to pay property taxes.
- The property tax is perceived of as unfair and it is the focus of much resentment.
 - Program review committee public hearings and testimony indicated a high level of frustration on behalf of the public and town officials with the annual growth of the property tax, increases due to revaluation, and overall dependence on the property tax.
 - According to a survey conducted in November 2005 by UConn's Center for Survey Research and Analysis, 69 percent of residents say reforming local property taxes is either an "Extremely Important" or a "Very Important" issue in influencing their vote in the 2006 governor's race.
 - Similarly, a 2002 survey conducted by the Center for Research and Public Policy at Fairfield University, for the Connecticut Conference of Municipalities, found over 81 percent of respondents agreed that the state and local tax systems in Connecticut needed to be overhauled to reduce the property tax burden, while nearly 71 percent agreed that property taxes should be reduced even if it means some state taxes are increased and some state tax breaks are eliminated.

- Because different property tax *rates* are applied to the same motor vehicles valued at the same price among different towns in the state, individuals in similar circumstances do not pay the same amount. For example, a taxpayer with a motor vehicle valued at \$20,000 would pay about \$220 in property taxes in Washington and over \$1,200 in Hartford.

POLICY OPTIONS: EQUITABLE	
Option Description	Implications
<p>C. Property Tax Refund Program</p> <p>Eliminate and redirect or modify current property tax credit from the income tax to better target tax relief to lower-income individuals through a refund program. This option would essentially be an expansion of the current circuit breaker program.</p> <p>The program could also include an asset test that considers the value of investments such as stocks, bonds, savings accounts, certificates of deposit, individual retirement accounts, and other real estate to ensure finer targeting of tax relief funding.</p> <p>The state of Maine, for example, offers a property tax and rent refund up to \$2,000 to single residents who earn less than \$74,500 per year and couples or residents with dependents who earn less than \$99,500. The property tax must exceed 4 percent of the applicant's income or the rent paid must exceed 20 percent of income. Also, the state of Maryland offers a credit to all homeowners whose net worth is less than \$200,000.</p>	<ul style="list-style-type: none"> • Depending on how the program is structured, some redirection of the property tax credit on the income tax could provide some of the funding given the current credit costs about \$275 million to \$300 million. • The current income tax credit is very popular with middle-income taxpayers, and depending how the new program is structured, this group may not realize any benefit under this proposal. • The current circuit breaker program is limited – the limits for an elderly single/couple are \$27,100/\$33,000 and the maximum benefit is \$1,000/\$1,250.
<p>D. State Sponsored Property Tax Deferral Program</p> <p>Create a property tax relief program for all Connecticut residents that defers that</p>	<ul style="list-style-type: none"> • A broad-based program that would help many taxpayers who have high property

POLICY OPTIONS: EQUITABLE	
Option Description	Implications
<p>portion of the tax on their primary residence that exceeds a certain percentage of income. It would also require payment to the town of an amount equal to the total amount of taxes deferred plus interest when the property is sold, changes owners, or a change in property use occurs.</p> <p>An example of eligibility guidelines could include the following requirements:</p> <ul style="list-style-type: none"> – Applicant must be a Connecticut resident for the last 12 months – Applicant must own and occupy a home in Connecticut for at least 6 months in the last year – Defer the amount of the property tax bill that exceeds 5 percent of household income – Maximum deferral amount plus simple interest (at prime rate plus 1 percent) and the balance of any mortgage cannot exceed 85 percent of the assessed value. – Proof of fire and homeowners insurance – Other requirements to maintain property <p>The tax deferral becomes a lien on the property with interest accruing on the deferred amount until the balance is paid.</p> <p>Municipalities would be required to administer the program, but the state would have oversight responsibilities and fund the program.</p> <p>To ensure better program targeting, the</p>	<p>taxes relative to income (the so called “cash-poor but house-rich”) and could cushion the impact of revaluation for individuals who find the rate of property appreciation has dramatically outstripped their income.</p> <ul style="list-style-type: none"> • Unlike this proposal, federally- sponsored and private reverse mortgages have an age limit (62 years). In addition, federally-backed reverse mortgages have an income limit. Reverse mortgages that are not federally backed tend to have very high interest rates. • According to an American Association of Retired Persons (AARP) study in 2002, 24 states and D.C. offered some type of government sponsored deferral program. The eligibility options varied, but most targeted the elderly with low- to moderate-incomes. • Unlike other deferred payment type loans, this proposal would not charge origination fees or other fees associated with obtaining a loan, and the interest rate is simple instead of compounded. • This proposal would require some form of state assistance (through bonding or other mechanism) to towns to finance the loss of funding during the deferral period. • An option for funding could be to redirect the current property tax credit from the income tax, which costs about \$275 million to \$300 million annually. • Deferral programs tend to be more targeted and less costly than other types of

POLICY OPTIONS: EQUITABLE	
Option Description	Implications
<p>definition of household income could be broad to include all income received by all household members (i.e., the applicant, applicant's spouse, and any dependants) including wages, pension, annuities, retirement income, investment income, Social Security income, veteran's benefits, Supplemental Security Income, and other income (e.g., rental income, non-taxable income, alimony, child support).</p>	<p>property tax relief because the deferred taxes are ultimately recovered.</p> <ul style="list-style-type: none"> • This option requires that a homeowner have equity in their home (about 40 percent under this proposal) in order to qualify. • This option addresses the lack of liquidity in a major asset, while minimizing the concern of homeowners who believe they may lose their homes because they cannot afford the taxes. • Homeowners may be reluctant to put a lien on their property and older property owners especially may not want to reduce the amount of the asset they have to pass on to their heirs. • If home ownership is considered a form of wealth, then this proposal, compared to any proposal for a property tax subsidy, would be a more equitable solution because the government would ultimately recoup the deferred taxes.
<p>E. Single Motor Vehicle Tax Rate</p> <p>Create a single property tax rate for motor vehicles either:</p> <ul style="list-style-type: none"> • at the median (middle) rate (half of the towns' rates are higher and half are lower); <i>or</i> • at a revenue neutral rate—that is at a rate that brings in the same amount of 	<ul style="list-style-type: none"> • The motor vehicle tax would be easier to understand from a taxpayer's perspective and simpler to administer. • The result would be more equitable -- everyone would pay the same tax rate and the same amount of tax on the same vehicle.

POLICY OPTIONS: EQUITABLE	
Option Description	Implications
<p>total revenue.</p> <p>Municipalities would still be required to administer the program.</p>	<ul style="list-style-type: none"> • It would eliminate the incentive to illegally register motor vehicles in communities with lower mill rates and reduce the amount of time assessors have to spend discovering this practice. • If the motor vehicle tax rate is established at the current statewide median mill rate of about \$27.00: <ul style="list-style-type: none"> – taxpayers in half of the towns would pay a total of \$46 million more in motor vehicle taxes, while taxpayers in the other half of the towns would pay about \$96 million less; – at the extremes, Greenwich would raise an additional \$10.4 million in motor vehicle taxes and Waterbury's taxes would be reduced by \$8.6 million; and – to prevent any town from losing money, the state would have to provide an additional \$96 million to towns who lose revenue. • If the motor vehicle tax rate is established at a revenue neutral mill rate of about \$29.45: <ul style="list-style-type: none"> – taxpayers in 101 towns would pay \$71 million more in motor vehicle taxes, while those in 68 towns would pay less; – at the extremes, taxpayers in Greenwich would pay \$12 million more in motor vehicle taxes and Waterbury taxpayers would pay \$7.8 million less; and – would require a redistribution mechanism through the state. <p>*See Appendix F for a town-by-town breakdown.</p>

V. Principle: Economically Competitive

Tax burden in a state should not be very different from other states, especially burdens in neighboring states.

CORPORATE INCOME TAX

Findings:

Taxes on businesses in Connecticut have been reduced significantly, and by most measures, are not considered more burdensome than other states.

- During the 1990s, Connecticut policymakers enacted several milestone tax policies aimed at making Connecticut more economically competitive, including:
 - allowing a sales-only factor for apportionment for certain businesses;
 - expanding the carry-forward period for corporate losses from five years to 20 years;
 - reducing the corporate income tax rate from 11.25 percent to 7.5 percent; and
 - creating and significantly expanding corporate tax credits.

- These legislative efforts appear to have lessened the tax burden on business in Connecticut.

- The corporate income tax rate in Connecticut is among the lowest in the Northeast as Table 1-2 shows.
- Measured by the share of corporate income tax revenue as a percent of gross state product, Connecticut businesses realized a 77 percent reduction in that ratio from 1989 to 2003, the 2nd largest decrease of all states.
- Using the same ratio – percent of corporate income tax revenue as a percent of gross state product – Connecticut currently ranks 24th (along with three other states) of the 46 states with a corporate income tax.

Table I-2 Corporate Income Tax Rates	
State	Rate
Connecticut	7.50%
Massachusetts	9.50%
New York	7.50%
Rhode Island	9.00%
Pennsylvania	9.99%
Vermont	7.00-9.75%
New Jersey	9.00%
Maine	3.50 - 8.90%
New Hampshire	8.50%

- By other measures -- from a 2004 study by the Federal Reserve Bank of Boston that used 2000 tax year data -- Connecticut business ranks:
 - 40th in business share of state and local taxes;
 - 28th in business taxes as a percent of personal income; and
 - 40th in business taxes as a percent of business profits.
- In interviews with the committee, Connecticut business community representatives indicate that while there are a number of factors that make up a state's economic climate, and taxes may not be highest on the list, "taxes do matter".

POLICY OPTIONS: ECONOMICALLY COMPETITIVE	
Policy Description	Implications
A. See Policy Options for Corporate Income Tax presented under the Neutral principle	Implications concerning corporate income tax changes are discussed under the Neutral Principle

PASS-THROUGH ENTITIES

Findings:

Connecticut's tax structure for pass-through entities, meaning limited liability corporations (LLCs), limited liability partnerships (LLPs) and S-corporations, appears favorably competitive to neighboring states.

- Pass-through entities in Connecticut pay a business-entity tax of \$250 per group. Other than that, for each pass-through entity income is "passed-through" to its members, and members pay only the personal income tax (three or five percent) on their portion of income the entity generates.
 - In New York, *each member* of an LLC or LLP is charged a \$100 filing fee, with the minimum fee being \$500, and the maximum \$25,000. Each member also pays the New York state income tax based on his or her distributive share.
 - In New Jersey, a \$150 *per partner* filing fee is required for each LLP and LLC partnership deriving income from New Jersey sources. For professional service entities (like accountancy), the \$150 fee applies to each registered professional who owns or is employed by the enterprise. The annual filing fee is capped at \$250,000.

- Recently, articles in the *New York Times*¹¹ identified Greenwich, Connecticut as having become a thriving financial “headquarters” for locating hedge funds, a relatively new area of financial investments. Because these funds are established as pass-through entities the only business income taxed is the personal income earned by the managers. The articles cite Connecticut’s lower rate than neighboring states as an attraction.
- Connecticut has experienced a 10 percent decline in the number of C-corporations since 2001, while there has been an increase of approximately 30 percent in pass-through entities during that period.
 - It is difficult to say how much of this shift in business types has to do with tax policy.
 - It is impossible to tell what portion of the personal income tax revenue comes from members of LLCs, LLPs, and the like. While such data are required to be submitted to DRS per C.G.S. Sec. 12-726 the data are not collected by DRS.¹²

PERSONAL INCOME TAX

Findings:

Connecticut’s personal income tax rates are low – three percent and five percent and Connecticut has the lowest tax rate, in the region, for joint income filers who earn \$100,000 or more.

Table I-3. Personal Income Tax Rates		
State	2005 Rates	Taxable Income Level (Joint filers)
Connecticut	5%	\$20,000
Massachusetts	5.3% or 12%	Depends on type of income
New Jersey	6.37% 8.97%	\$75,000 to \$500,000 \$500,000 and over
New York	7.25% 7.7%	\$100,000 \$500,000

- While Connecticut’s personal income tax rate is close to that of Massachusetts, Massachusetts taxes short-term capital gains (held less than one year) at 12 percent. (Based on IRS federal return data, Connecticut is one

¹¹ *New York Times*, September 4, 2005 and December 18, 2005

¹² C.G.S. Sec. 12-726 states: Each partnership having any income from or connected with sources within this state...shall make a return for the taxable year setting forth all items of income, gain, loss, and deduction and the name, address, and social security or federal employee identification number of each partner, whether or not a resident of the state, the amount of each partner’s distributive share of [a variety of items]. (Emphasis added).

of the highest-ranked states in terms of high unearned income, including capital gains).

- Effective tax rates – the percent of income paid in taxes after all deductions and exemptions -- are generally higher for higher-income filers (\$500,000) in neighboring states than in Connecticut as shown in Table I-4.

Table I-4. Effective Tax Rates for High Income Filers		
<i>State</i>	<i>Income Group</i>	<i>Effective Rate</i>
Connecticut (2003 returns)	\$54,001-\$90,000	3.41%
	\$90,001-\$2 million	3.83%
	\$550,000 and over	3.53%
New Jersey (2003 returns)	\$90,000-\$100,000	2.6%
	\$100,000-\$150,000	2.2%
	\$500,000-\$1 million	4.2%
New York (estimated 2005)	\$75,000-\$100,000	4%
	\$500,000-\$1 million	5%
Massachusetts (2000 returns)	\$158,315	4.5%
	\$443,000	4.3%

OTHER ELEMENTS OF ECONOMIC COMPETITIVENESS

Findings:

In addition to tax policy, there are other important measures that impact Connecticut's economic competitiveness.

- Total government spending as a percent of gross state product is relatively low in Connecticut, indicating that the private sector makes up more of the economy, a measure of competitiveness.
 - Connecticut ranks fourth from the bottom of all states – with all levels of government contributing 8.7 percent of Connecticut's gross state product.
 - The table below shows that Connecticut is second-lowest among Northeastern states, and substantially below the U.S. average.

Table I-5. Percent of Gross State Product Attributed to Government: A Comparison									
State	CT	MA	ME	NH	NJ	NY	RI	VT	US avg.
Percent	8.7%	8.5%	14.2%	9.0%	10.1%	10.2%	11.8%	13.1%	11.9%
Source of Data: Bureau of Economic Analysis, 2005									

- Despite tax policies and government spending that appear to be economically competitive, Connecticut's competitive status gets mixed results.
 - Recent data show Connecticut still has the highest per capita income, substantially ahead of second-place New Jersey.
 - However, other data indicate Connecticut's competitive position is not great. The rise in the state's personal income between 1993 and 2003 was less than the U.S. personal income growth, and Connecticut's job growth lags behind almost all other states as reported by the Federal Deposit Insurance Corporation in June 2005.
 - A September 2005 report issued by the Connecticut Economic Resource Center, benchmarking Connecticut's economy, identified several impediments to growth including population shifts. Connecticut has the 8th-oldest population in the country. Further, the report points out Connecticut had the greatest decline in the population between 18-34 years old (23 percent decrease) of any state in the nation during the 1990s.
 - Connecticut is a high-cost state. Its 2004 average hourly wage of \$17.88 is the second highest in the country. Its energy costs are the 5th-highest in the country, and Connecticut's health care costs are the third-highest on a per capita basis, after D.C. and Massachusetts. These cost factors may affect Connecticut's competitive position more than any corporate, business entity, or personal income tax policies.

SALES AND USE TAX

Findings:

- In Connecticut businesses pay a greater share of the sales tax than in most states.¹³
 - In FY 03, Connecticut, consumers paid 51 percent and businesses paid 49 percent of the state's total revenue from the sales tax.
 - In comparison, the national average for the consumer share of the sales tax was 57 percent and business, 43 percent. The average consumer share for neighboring states (RI, ME, MA, NJ, and NY) is 54 percent and 46 percent for business.
- In comparison to its neighboring states -- Massachusetts, Maine, New Hampshire, Vermont, New York, New Jersey, and Rhode Island -- Connecticut ranks first in the number of services taxed.¹⁴

¹³ Council on State Taxation, *Sales Taxation of Business Inputs: Existing Distortions and the Consequences of Extending the Sales Tax to Business Services* (January 2005), p.5.

- Connecticut (80 services)
 - New York (56 services)
 - New Jersey (55 services)
 - Rhode Island and Vermont (29 services)
 - Maine (24 services)
 - Massachusetts (19 services)
 - New Hampshire (11 services)
- Table I-6 contains the major categories for services possible for a state to tax and the number within each category Connecticut currently taxes. It also shows where Connecticut ranks on the number of services taxed in each category compared to all 50 states. (See Appendix G for additional tables detailing the services within each category and for a comparison of the types taxed in Connecticut verses other neighboring states.)

Table I-6. Major Categories of Services Typically Taxed		
<i>Type of Service</i>	<i>Number Taxed in CT</i>	<i>Connecticut Ranking</i>
Business Services	20	7th
Professional Services	0	n/a
Computer Services	6	8th
Finance, Insurance and Real Estate	0	n/a
Utilities	10	19th
Personal Services	10	13th

- In general, states taxing as many or more services as Connecticut are not among its primary competitors. The states taxing a broad array of services include: Hawaii (taxing all business activities under a general excise tax), Washington, New Mexico, South Dakota, Delaware, West Virginia, Iowa, Texas, and Nebraska.

¹⁴ Federation of Tax Administrators, Sales Taxation of Services, 2004. Available at <http://www.taxadmin.org/fta/pub/services/services04.html> , download date 9/15/05.

POLICY OPTIONS: ECONOMICALLY COMPETITIVE	
Option Description	Implications
<p>B. Tax Final Consumption Not Business Inputs</p> <p>Tax goods and services being sold and not business inputs used to develop final products.</p> <p>This option eliminates taxes on business services that are anticompetitive (i.e., business analysis, management consulting, public relations, employment agencies, and advertising agency fees), and taxes additional personal services purchased by consumers to replace the revenue lost from taxing business services/inputs.</p> <p>Services subject to sales tax would be those that are bought and sold in the marketplace as a commodity (i.e., salon and barber shop services, spa services, gift wrapping services, personal instruction services, and shoe repair).</p>	<ul style="list-style-type: none"> • Alleviates tax burden inequalities between businesses in Connecticut and competitor states. • Shifts the burden from business services to personal services, which do not impact economic competitiveness to the same degree as consumers are less likely to relocate. • Residents of towns that border other states may consume personal services in those states. • Makes the sales tax easier to administer since there are no interpretation or definitional issues about what should or should not be taxed. • There will be an increase in the workload for DRS staff as there will be more retailers submitting sales tax returns. • Makes the tax more transparent. Consumers pay the tax when making purchases. • There are no data to demonstrate whether this option would be revenue neutral, cause a decrease in revenue, or an increase in revenue to the state. Should the tax on business services be exempt without adding the sales tax to additional personal services this option would decrease revenue collections.

PROPERTY TAX.¹⁵

Finding:

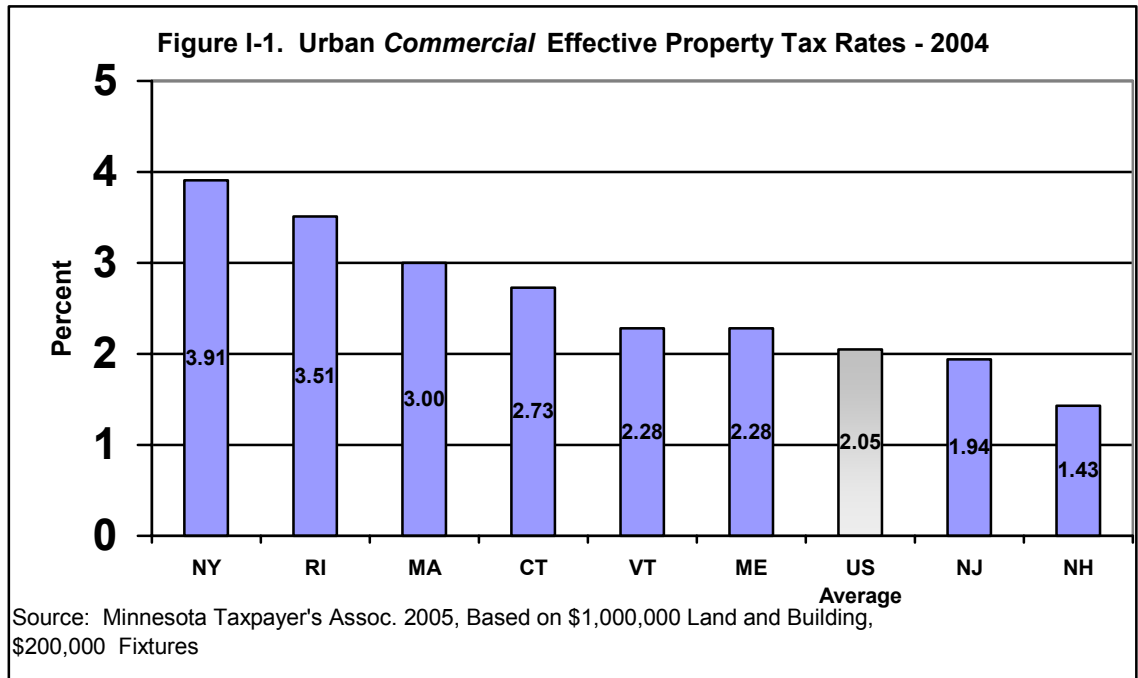
The effective property tax rates on industrial and commercial property in Connecticut's cities are not competitive. Connecticut's rates are among the highest in the Northeast and in the nation.

- Table I-7 compares Connecticut's policy on taxing business inventory and machinery and equipment to those of other states in the Northeast (New England, New York and New Jersey). Like most of the Northeastern states, except Vermont and Rhode Island, Connecticut municipalities do not levy an inventory tax on business.

Table I-7. Tax on Inventory and Manufacturer's Machinery and Equipment		
State	Inventory Tax	Manufacturer's Machinery and Equipment Tax
Connecticut	No	Partial
Maine	No	Partial
Massachusetts	No	No
New Hampshire	No	No
New Jersey	No	No
New York	No	No
Rhode Island	Yes	No
Vermont	Yes	Yes
Number of States Nationwide with this Tax	15	36
Sources: NCSL 2002 for Inventory Tax and Connecticut Business and Industry Association 2005 for Manufacturer's M&E tax.		

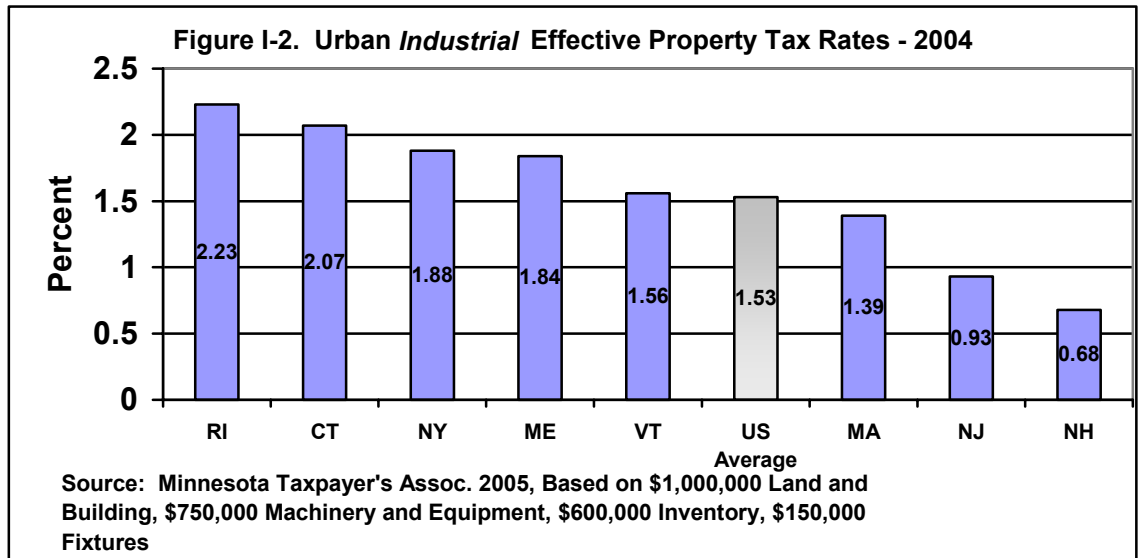
- In the Northeast, only Connecticut, Vermont, and Maine allow municipalities to tax manufacturer's machinery and equipment; however, 33 other states allow municipalities the option of levying this type of tax. Vermont allows municipalities to fully exempt manufacturers from this tax, while Maine and Connecticut partially exempt this tax. (Connecticut provides for a five-year, 100 percent exemption of local property taxes on newly acquired manufacturing machinery and equipment and reimburses municipalities for a portion of the exemptions.)

¹⁵ Comparing the tax treatment of business property among the states is inherently difficult. Simply comparing rates is not adequate. Both states and municipalities may offer full or partial exemptions on land, buildings, machinery, equipment, inventories, and other business personal property. Property assessment practices also vary. Because there are thousands of local governments, there can be considerable variation in tax burden that does not lend itself to a simple evaluation. In addition, states may offer specific economic development packages to certain businesses that include property tax incentives that make comparisons difficult.



- Figure I-1 compares the FY 2004 effective tax burden for *commercial* property valued at \$1.2 million in the most populous cities in each of the Northeast states as well as the U.S. average. Connecticut's effective tax rate was fourth highest in the Northeast, 13th highest in the nation, and was 33.3 percent higher than the U.S. average.¹⁶ (For more information about this study, see Appendix H).
- The same study also compared "typical" rural communities nationwide. The tax burden for a commercial property valued at \$1.2 million in rural Connecticut had an effective tax rate of 1.57 percent and ranked 24th in the nation, or 5 percent *below* the national average.
- Using the same methodology as above, Figure I-2 compares the tax burden for *industrial* property valued at \$2.5 million among the most populous cities in each of the Northeast states as well as the U.S. average. With an effective tax rate of 2.07 percent, Connecticut ranks second highest in the Northeast and 9th highest in the nation. In comparison, the effective tax rate in rural Connecticut for industrial property valued at \$2.5 million, at 1.33 percent, ranked 17th in the nation and 9 percent above the national average.

¹⁶ The effective tax rate is the total tax divided by the total value of property.



- Connecticut generally avoids the use of mechanisms that serve to shift the tax burden from residential property to business property.
 - Except in the case of farmland, forests, and designated open space, the state does not have different assessment ratios or valuation requirements for different classes of property. These techniques that are employed in many other states lower the legal assessment levels for residential property.
 - The state, also, does not have a general homestead exemption¹⁷, although it does allow for a few smaller homestead credits or local option exemptions for individuals meeting certain requirements.

POLICY OPTIONS: ECONOMICALLY COMPETITIVE	
Option Description	Implications
C. Reduce or Eliminate the Tax on Manufacturer's Equipment and Machinery.	<ul style="list-style-type: none"> • The change would make Connecticut's property tax burden on business more competitive in the region and nation. • Eliminating the tax would be consistent with the principle that business inputs should not be taxed. • The option would reduce revenues to towns and replacement revenues would have to be found.

¹⁷ A homestead exemption reduces property taxes on residential property by exempting a certain amount of the home's value from taxation.

POLICY OPTIONS: ECONOMICALLY COMPETITIVE	
Option Description	Implications
	<ul style="list-style-type: none"> The option would place manufacturers – who are more dependent on updating equipment and machinery to conduct their business – on a more level playing field with other types of commercial enterprises.
D. See all Policy Options under Balanced Principle to reduce property tax reliance overall.	Implications are discussed under the Balanced Principle.

VI. Principle: Neutral

A tax system should not be used to influence economic decisions on spending or investments.

Findings:

Connecticut has been more restrained than most states in using tax policy to influence economic behavior or in creating dedicated funds. The major exception is that Connecticut has used the corporate income tax to attempt to promote economic development.

- Connecticut has not extensively used its personal income tax structure to treat income types differently or offer many exemptions or credits.
 - Connecticut offers only two credits from its income tax; many states offer more than 15.
 - Connecticut treats virtually all income the same. (Only Social Security is exempt but only if a filer's income is below a certain level, and in the future, only half of military retirements will be taxed.) Most other states treat certain types of income (e.g., pensions, retirements, capital gains) differently from wage income.
- The only major earmarking occurs with the Special Transportation Fund; special dedicated funds appear much more prevalent in other states.
- Connecticut's sales tax contains many exemptions, but often the exemptions apply to items considered necessary like groceries and medicines, which tends to promote equity and lessen the regressiveness of the tax.
 - Connecticut has frequently used the corporate income tax (CIT) structure to influence business decisions, as outlined previously.
- Because of the variations to the corporate income tax, it is difficult to administer and corporations with resources can minimize taxes owed resulting in lower revenues and making compliance difficult to gauge and enforce.
 - Corporate income tax revenues have declined considerably in inflation-adjusted dollars.
 - Corporate income tax revenues have declined both as a percent of state revenues and a percent of gross state product.
 - Audits of the corporate income tax accounted for 2.6 percent of all audits but resulted in 36 percent of the assessment amounts

resulting from audits, which may be a measure of tax minimization and avoidance.

- Currently, at least half of the 44,277 corporations in Connecticut pay only the minimum tax.
 - Eighteen of the top 100 (based on total sales for 2003) corporations headquartered in Connecticut paid the minimum CIT. Only 82 of the top 100 companies paid the corporation tax; others paid the \$250 business entity tax. Only one corporate filer paid more than \$1 million in CIT taxes, after credits.
 - Overall, corporate income tax liability is reduced about 23 percent through credit use. However, the use and value of tax credits is concentrated; fewer than 13 percent of corporations take any credits, and only 13 corporations took five or more credits.
 - The credits to the 13 filers were valued at about \$20 million, or almost one-quarter of the overall CIT liability reduction.
 - Current use of the credits is also concentrated in certain types of industry. Manufacturing accounts for about 10 percent of corporate filers, and 22 percent of corporate tax liability, yet manufacturing accounts for over half of the reduction in liability. (See Appendix I for a list of credit usage by industry).
 - Most of the growth in businesses has been in pass-through entities. The number of these entities has grown about 30 percent since 2001, while the number of C-corporations has declined 10 percent during the same period. Only C-corporations are eligible to use credits to offset tax liability.
- There is difficulty in evaluating the ongoing effectiveness of legislative changes intended for a particular purpose. While corporations may be able to superficially demonstrate the use of a particular feature or credit (e.g., number and value of research and development credits taken) it is difficult to assess whether these policies are achieving the desired outcome. However, there are legislative efforts underway to increase the oversight of these credits and how beneficial they are.
 - A study by the University of Connecticut's Center of Economic Analysis¹⁸ (CCEA) for the legislature's Finance, Revenue and Bonding Committee found that corporate rate reductions and the credit and exemption programs enacted in the 1990s have been a "mixed and small success for the Connecticut economy". It also found that rate reductions had a greater positive impact than exemptions or credits.

¹⁸ CCEA, The Economic Impact of Connecticut's Corporate Tax Policy Changes: 1995-2102, Re-released December 2005, p i. The center's report used the REMI econometric model, a regional calibrated model developed for Connecticut, to arrive at its findings.

- The Business Tax Policy Review Committee has statutory authority to examine and analyze tax credits and revise those not having a measurable benefit to the state.
- Based on usage alone (not considering other measures of effectiveness), 10 of the 26 credits are used by five or fewer filers, and 6 of the 26 credits each account for \$5,000 or less in credit value. By this measure these credits appear of little benefit to the state's economy, and should be eliminated.

POLICY OPTIONS: NEUTRAL	
Policy Description	Implications
<p>A. Reduce the Corporate Tax Rate and Eliminate Credits</p> <p>Reduce the corporate tax rate on net income by half –to 3.75 percent – but eliminate the use of credits.</p> <p>Economic Development <i>grants</i> would continue.</p>	<ul style="list-style-type: none"> • This option would raise about \$109 million less in revenue –at least initially. The loss from the rate cut would be about \$202 million, but about \$93 million would be recaptured as a result of eliminating tax credits for a net loss of about \$109 million. • This option would make the system fairer by eliminating the use of credits with which some corporations are able to reduce their tax liability significantly. • Reducing the rate to 3.75 percent would make Connecticut's CIT rate one of the lowest in the country, and might be as beneficial as credit use in spurring growth in jobs and income. • The growth in non-C corporations indicates credit use may not be a great economic development incentive in spurring job growth. • The option would promote the principle of neutrality by stopping the practice of using the tax code to select types of businesses or

POLICY OPTIONS: NEUTRAL	
Policy Description	Implications
	<p>activities for beneficial treatment and might help with <i>Cuno</i>¹⁹ compliance, depending on the Supreme Court decision.</p> <ul style="list-style-type: none"> • The lower rate would benefit all corporations – not just large ones or those in a certain category. Lowering the rate appears to offer most benefit to economy, according to CCEA study. • The option would promote the principle of equity through a broader base and lower rate, and lessens economic distortions. • This option makes the tax easier to administer; rate is based on income and not reduced by credits.
<p>B. Replace the Corporate Income Tax with a Broad-Based Tax on Gross Receipts.</p> <p>A gross receipts tax would be levied on the total receipts of all goods sold and services rendered in the state. It would not allow for deductions for the costs of goods, labor, delivery, taxes, or other deductions.</p> <p>Set the rate on all receipts over \$1 million at about 0.26 percent –similar to Ohio.</p> <p>Eliminate the use of tax credits; economic development grants would continue under DECD.</p>	<ul style="list-style-type: none"> • The option applies the tax to any type of business transaction – sales, all services, and rentals—and applies it to any size and types of business, from sole proprietors, to partnerships to large corporations. • This is not widely used tax; the state of Washington has a business and occupations tax with six major classifications taxed at rates from .00138 percent to .00471 percent. Michigan has had a hybrid business activity tax, like a value-added tax. Ohio is in year one of a five-year phase-in of a gross receipts tax to replace its corporate income tax. Businesses will pay only the \$150 minimum on receipts up to \$1 million, and 0.26 percent on receipts over \$1 million. • Restructuring the business tax in a state is not a guarantee of more stability or of

¹⁹ *Cuno v. Daimler Chrysler, et al.* is a case that is to be heard by the U.S. Supreme Court, appealing a federal circuit court decision that determined Ohio's use of tax credits is unconstitutional.

POLICY OPTIONS: NEUTRAL	
Policy Description	Implications
	<p>improving economic competitiveness. Washington experienced incredible volatility in its tax structure from 1999 through 2004; Michigan's economy is in serious trouble and the state is examining further significant restructuring. Indiana had a gross receipts tax, but it was eliminated in 2002 because it was viewed as anti-competitive.</p> <ul style="list-style-type: none"> • It is difficult to predict what a gross receipts tax in Connecticut would generate in revenue. The business and occupation tax in Washington totaled \$2.067 billion in FY 04, with a gross state product of \$261.5 billion (0.79 percent of gross state product (GSP). Using Connecticut's 2004 GSP as a base (\$185.8 billion), and estimating a similar collection ratio of GSP (0.79 percent of GSP) a gross receipts tax might raise about \$1.4 billion. • However, a gross receipts tax might have implications for other taxes like the personal income tax or the sales tax. Washington does not have a personal income tax; some of the gross receipts tax in that state is likely capturing some of what the PIT tax captures here. • Exemptions, deductions, and credits are used in Washington and Michigan and begin to erode the value of this type of tax. Also, the tax requires exemptions etc. for sales made out of state, thus the issue of in-state and out-of-state business activity still exists. • This type of tax creates winners and losers. The business community in Connecticut gave mixed review of the Ohio plan indicating only minor increases in the rate can have significant tax implications. Further, the national business tax policy

POLICY OPTIONS: NEUTRAL	
Policy Description	Implications
	organization, Council on State Taxation, opposes the Ohio gross receipts tax indicating it lacks transparency, diminishes neutrality and makes Ohio business less competitive.
<p>C. Modify Corporate Tax by Changing Certain Factors</p> <p>Modify the corporate income tax structure in Connecticut in several ways to:</p> <ul style="list-style-type: none"> • Return to 5-year carry-forward period for net operating losses (NOL) rather than current 20-year period. • Limit the deduction of NOL to 50 percent of entire net income • Limit a corporation's credit use to same ratio as its apportionment fraction. (For example, if only 20 percent of a corporation's income is earned in Connecticut, limit its credit use to the same fraction.) • Maintain the corporate income tax structure, but apply an alternative minimum assessment (like New Jersey) either on gross receipts (excludes up to \$2 million in receipts) or on gross profits (excludes up to \$1 million in profits) with graduated rates depending on amount of receipts or profits. Maximum tax is \$5 million. • Use a computed alternative minimum tax as a substitute for the current minimum tax of \$300; corporations that would be subject to the alternative minimum tax would not be permitted to reduce it through tax credits. 	<ul style="list-style-type: none"> • Other states have tightened the corporate income tax successfully. • These proposed modifications are similar to those taken in New Jersey to tighten its CIT, which increased revenues from the CIT about \$1 billion without raising the rate. • Brings an element of fairness to the use of credits by using the same ratio as the company's business in Connecticut (the apportionment formula). • This would help alleviate the issue of corporations reducing their tax liability down to the minimum (\$300 for 2003). • Twenty-five other states use either a "throwback" or "throwout" rule, which lessens the impact of placing sales in a state with no corporate income tax. • Tightening the sheltering and reporting requirements for corporations rather than adopting either option one or two would lessen a perception that businesses can minimize taxes that individuals cannot. If these proposals were implemented, individual income taxpayers would have more assurance that corporations must also

POLICY OPTIONS: NEUTRAL	
Policy Description	Implications
<ul style="list-style-type: none"> • Apply a “throwout” rule to calculate the apportionment formula – those sales that are apportioned to a state where they are not taxed are removed from the numerator and denominator. • Other modifications to corporation business tax should be considered by the Business Tax Credits and Tax Policy Review Committee (BTCTPRC): • Place recommendations of the Multi-state Tax Commission 2004 Report on Corporate Tax Sheltering on the committee’s agenda for consideration during 2006. • The BTPCRC should establish reporting requirements on the use of credits establish “effectiveness” criteria for continuation of the credits, and consider a “sunset” schedule for tax credits, beginning with those not frequently used. 	<ul style="list-style-type: none"> • “play by the rules” and pay their fair share. • The Multistate Tax Commission report estimates that Connecticut loses about 25 percent of CIT because of tax sheltering. In 2001 the loss estimate was almost \$100 million. These proposals would tighten these shelters and perhaps recapture some of the losses. • The Business Tax Credits and Tax Policy Review Committee is an appropriate entity to address the Multi-state Tax Commission recommendations. Some of the commission’s proposals, like unitary filing (i.e., ignores the formal corporate structure and treats the income of subsidiaries as if they were divisions of the same parent) are controversial and need to be explored by policymakers on the committee with input from DRS tax administrators to determine the best way to proceed. • There are other states that are tightening their approach to credits. Michigan has begun to use a “sunset” approach to some of the tax credits. Washington state legislature required its Department of Revenue to survey companies using three selected tax deferral or credit programs and analyze and report on the results at five-year intervals so the legislature can begin evaluating whether the incentives are having an economic impact or not.

ESTATE TAX

Findings:

Connecticut is one of a minority of states that has retained an estate tax, which can, like other transfer taxes, prompt tax planning and affect taxpayers’ investment and location decisions. Research on the full economic impact of estate taxes is inconclusive and data

available to assess Connecticut's current combined estate and gift tax that went into effect only last year are limited.

- At present, Connecticut is one of only 18 states and the District of Columbia that imposes an estate tax.
 - All eight states in the Northeast region except New Hampshire currently have estate taxes.
 - Connecticut was planning to phase out all of its transfer taxes (i.e., estate, gift, and succession) by 2010 and, in fact, the previous estate tax expired on December 31, 2004. However, to help address the state's serious budget problems, a new combined estate and gift tax with a retroactive effective date (January 1, 2005) was enacted during the 2005 regular legislative session. (The state's succession tax and prior gift tax were also eliminated as of January 1, 2005.)
- Transfer taxes like estate, inheritance, and gift taxes are generally considered among the most progressive types of taxes but are not economically neutral.
 - Estate taxes are paid by a small number of high-wealth individuals. (Nationally, it is estimated only 2 percent of all estates are large enough to have any estate tax liability.) The current Connecticut estate tax applies only to taxable estates over \$2 million.
 - There is evidence a significant amount of giving (gifts and bequests including charitable donations) is tax-motivated and that some individuals may change their state of residence ("migrate") to avoid high state tax liabilities including estate taxes.²⁰
 - A recent study by two university professors suggests migration and other avoidance behaviors in response to estate taxes would cause some economic losses but they would not be large compared to the revenues such taxes raise for states.²¹
- At this time, academic research on the role and effect of transfer taxes mostly raises rather than answers questions and seems best used to clarify policy trade-offs and issues for further study. Little or no reliable evidence has been presented to support claims that estate taxes negatively effect family-held

²⁰ "Rethinking the Estate and Gift Tax," William Gale (Brookings Institution Fellow) and Joel Slemrod (Professor, Business Economics and Public Policy, University of Michigan), Brookings Institution Conference Report, March 2001.

²¹ "Do the Rich Flee from High State Taxes? Evidence from Federal Estate Tax Returns," Jon Bakija (Economics Department, Williams College) and Joel Slemrod (Director, Office of Tax Policy Research, University of Michigan Business School), July 2004.

business or farms, reduce savings and impair economic growth, or generate huge compliance costs.²² In addition, there is considerable academic and political debate over estate tax equity issues that involve views about fairness as much as empirical research findings (e.g., whether estate taxes promote fairness by reducing unequal opportunities and concentration of wealth, cause horizontal inequity because taxpayers with the same wealth are treated differently depending on their approach to estate planning, etc.).

- Estate tax revenues are highly volatile (since in any given year they depend on how many wealthy individuals die and leave large estates or, as part of their tax planning, decide to make taxable gifts) and a very small part of total tax collections.
 - On average, revenues from the Connecticut's estate tax make up about 2 percent or less of total state tax collections and approximately 1 percent or less of combined state and local tax revenues.
 - Annual revenues collected from Connecticut's former estate tax ranged from almost \$30 million to nearly \$112 million between FY 00 and FY 04 .
 - The new combined estate and gift tax is estimated to generate around 500 estate tax filings per year and produce about \$108 million in FY 06, \$150 million in FY 07, and \$152 million in FY 08. (These are estimated revenues solely from the new tax and do not include any residual collections from the prior state estate, gift, and succession taxes.)
 - During the current fiscal year, one very large payment (about \$21 million) was made under the new estate tax.
- Connecticut's new combined estate and gift tax has a threshold of \$2 million, meaning individuals with estates valued less than \$2 million have no estate tax liability. However, a taxpayer with an estate valued at just one dollar over the threshold becomes liable for taxes on the entire value of the taxable estate. Many view this sharp eligibility "cliff" as unfair and believe an exemption, perhaps set at even a higher level, would be more equitable as well as acceptable to taxpayers than the current threshold.
 - An accurate estimate of the fiscal impact of instituting an exemption at the \$2 million or any level cannot be made at this time.

²² Ibid, Gale and Slemrod.

POLICY OPTIONS: NEUTRAL	
Option Description	Implications
<p>D. Eliminate the Connecticut Estate Tax</p> <p>Repeal the current statutory provisions for the state's combined estate and gift tax.</p>	<ul style="list-style-type: none"> • Elimination of the state's estate tax would improve revenue system neutrality and remove any disincentive the tax presents for residing or locating in Connecticut. • Repeal of the new estate tax would result in revenue losses to the state, perhaps up to \$150 million per year, and diminish progressivity of the overall revenue system. • While estate tax collections tend to be very volatile and difficult to forecast, these revenues have helped the state to deal with unexpected economic downturns and periodic budget gaps. • Without any kind of transfer tax, the state loses the opportunity to tax wealth of very high income individuals that may otherwise go untaxed (e.g., appreciation of held assets, unrealized capital gains) and contribute to further concentration of wealth.
<p>E. Replace Current Estate Tax Threshold With an Exemption</p> <p>Eliminate the existing threshold for tax liability and establish an estate tax exemption for at least the first \$2 million of a taxable Connecticut estate.</p>	<ul style="list-style-type: none"> • Creating an exemption to estate tax liability rather than a threshold eliminates the current eligibility "cliff," which improves the fairness and acceptability of the tax. • Establishing an exemption will reduce revenues produced but the amount lost cannot be estimated accurately with currently available data.

VII. Principle: Promotes Compliance

A tax system should be easy to understand and comply with and minimize compliance costs for taxpayers and tax program administrators.

Findings:

The vast majority of state tax revenue in Connecticut is collected through voluntary compliance.

- The state personal income tax is relatively simple, which promotes taxpayer compliance.
 - Connecticut's personal income tax treats most income similarly, and has only two rates.
 - The personal income tax has only two credits; many states have 15 or more credits.
- The sales tax has many exemptions, but it is applied only at the state level and has essentially only one rate. Consumers pay the tax at the time of purchase, and retailers remit the taxes monthly or quarterly.
 - Cash businesses pose compliance problems, but DRS plans to address the problem with new software (D-Tax) and its overall new ITAS system.
- Connecticut has higher than average excise tax rates that increase vulnerability to evasion.
 - For example, Connecticut has the 6th-highest cigarette tax, at \$1.51 a pack, which prompts cigarette buyers to seek other ways and places to buy the product.
- The complexity of the corporate income tax provides many opportunities for reducing tax liability.
- Compliance rates for the local property tax, which is probably the most transparent tax, are very high, with almost 98 percent of taxes collected. Compliance rates are also helped with many people paying their property tax through their mortgage lender.

Connecticut's state tax agency, the Department of Revenue Services, has made progress in helping taxpayers comply with tax law by automating its filing, payment, and taxpayer information activities.

- Operations that can be conducted electronically improve accuracy and speed, making compliance simpler and less costly for taxpayers.
- The DRS website is easy to access, is user-friendly, and offers forms, publications, and information on the various state taxes, and how to complete and submit a return. The website is accessed more than 200,000 times each month, on average.
- DRS operates a call-center where taxpayers can call an “800” number and get answers to specific tax questions. DRS received approximately 152,963 calls from January through June of 2005 and a total of 197,863 for 2004.
- Connecticut is ahead of most other states in promoting electronic filing of returns -- 67 percent of personal income tax returns are filed electronically, while the national average is 54 percent. This effort has been strengthened by regulations mandating tax preparers to file electronically.
- A key indicator of the success of efforts to promote compliance is what is generally referred to as the “tax gap” of a revenue program or system. A tax gap is generally defined as the difference between tax liability (what is owed under full compliance with all tax laws) and taxes voluntarily paid. The difference results from taxpayers not filing at all, underreporting their liability, or not paying all taxes owed.
 - Identifying the amount and reasons for taxpayer noncompliance can help administrators determine the effectiveness of their enforcement and collection activities as well as the need for tax policy changes that could improve voluntary compliance.
 - Estimating tax gaps, particularly for income taxes, is a major undertaking, requiring sophisticated analysis and large sets of data. A few states (e.g., California, Minnesota, and most recently, New York) and the federal IRS regularly conduct tax gap studies, but most jurisdictions including Connecticut do not, usually due to limited research resources.
 - Results from analysis conducted by the IRS and the above states indicate that the personal income tax “gap” is between 10 and 15 percent of tax liability.
 - Connecticut’s ability to develop state tax gap information will significantly improve with the full implementation of DRS’s new automated information system (ITAS). A high level of voluntary compliance is the primary goal of state

tax agencies, and tax gap is a critical indicator of performance in this area.

Recommendation:

2. Once ITAS is fully in place, DRS should make estimating and reporting of tax gap a priority of future agency research. A more precise picture of the extent and areas of non-compliance should assist DRS in developing an overall strategy to promote compliance and deter tax avoidance.

- A major way state tax agencies including DRS are seeking to improve compliance rates is through expanded and improved system automation. New software programs in combination with data warehouses containing extensive tax and other financial and regulatory information are being used to address noncompliance with targeted audit and enforcement efforts in several states.
 - Last year, Massachusetts invested \$4 million in a software program to discover tax evaders (DTAX) that generated \$70 million in new revenue collections during its first year of use. In addition to interconnecting data from multiple sources to identify noncompliance, the program computes payment data and generates bills. The program also automates the refund process for taxpayer overpayments, allowing reallocation of audit and collection staff time to compliance activities.
 - Connecticut is developing a similar automated auditing program (Discover Tax) that will be applied to new ITAS data warehouse to identify non-filers. In its original budget option regarding this program, DRS estimated it would produce \$49 million in new revenues because of better application of the agency's audit resources.
 - Improved automation provided by ITAS has increased the effectiveness of a number of the agency's special compliance projects and will permit the development of new efforts. For example, a special unit in the Audit Division has focused on using cross-agency information on alcohol purchasing and volume to better calculate and enforce the alcohol excise and sales taxes on alcohol. DRS has also submitted a budget option for a licensing renewal compliance project that would involve ensuring various tax obligations are settled before an applicant can renew most state licenses (driver's licenses and vehicle registrations would be excluded). With new and expanded computer capabilities, DRS could pursue a similar tax compliance

requirement for all vendors and contractors seeking to do business with the state.

- The results of the department’s special compliance projects are not formally tracked, compiled, or reported. Documentation of the outcomes could be used to evaluate their effectiveness as well as demonstrate their value and build legislative support for continued or additional investment in staff and other resources associated with successful projects. In addition, public reporting of compliance results might act as a deterrent for those looking to avoid or underpay taxes.

Recommendations:

- 3. DRS should conduct a cost benefit analysis of each major tax compliance initiative, including amnesty programs, and report the results to the appropriations committee.**
 - 4. DRS should publicly report the results of tax compliance efforts on its website. Such efforts assure the taxpaying public that non-payers are being detected and promote overall compliance.**
- There are other efforts in which DRS participates, to varying degrees, that also promote compliance and detect non-compliance.
 - DRS is an “associate” member state in the Multi-state Tax Commission, an organization of state government tax agencies that work with taxpayers to administer tax laws efficiently and equitably. This is the minimum-level of participation a state can have. Membership features include participation in a joint audit program, national nexus program, property tax fairness project, and the property tax audit program.
 - The commission has in the past few years formed working groups that issued reports with proposals aimed at improving compliance in three tax areas: corporate tax sheltering, pass-through entities; and the sales and use tax. Three DRS staff served on the working group dealing with pass-through entities, but not on the other two.
 - DRS also participates in the Federation of Tax Administrators (FTA), an organization made up of the principle state taxing agencies in all 50 states. Some of the ways in which such membership helps with compliance is through adopting uniform definitions among states, or in states implementing model agreements to help taxpayers

- comply with a certain tax. For example, Connecticut uses sale and use tax compliance agreements (SUTCAs) or (labeled management compliance agreements in Connecticut), endorsed by the FTA, that ease the process of reporting and collecting sales tax.
- Another FTA project facilitates sharing of successful compliance strategies and techniques. Connecticut is one of 14 regular participants in this exchange.
- DRS periodically offers amnesty programs, authorized by the legislature, which provide non-compliant taxpayers an opportunity to remit taxes owed without penalty, and typically DRS grants a grace period when a new law takes effect before instituting penalties for noncompliance.
 - Three amnesty programs have been offered since 1990: one in 1990; 1995; and the last one in 2002. Amnesty periods for the three programs each lasted three months, from September 1 through November 30.
 - A state law passed during the 2005 session penalizing those found to be engaging in abusive tax shelters. The law became effective January 1, 2006. DRS granted an amnesty period for people to declare before that date, with reduced penalties.
 - DRS does not use all enforcement tools it should to deter non-compliance.
 - For example, DRS is not consulted before state contracts or awards are granted to ensure the person or business being issued a grant or award is not delinquent in payment of taxes. The IRS found earlier this year that billions of dollars of defense contracts were being awarded to businesses delinquent in tax payments. While no state figures on this exist, it seems to make good public policy sense not to reward those who don't comply with state tax laws.
 - DRS does not report delinquent taxpayers to credit reporting agencies, although DRS indicates that private collection agencies under contract with the department do report that information. The committee contacted the Federation of Tax Administrators and NCSL requesting information on which state tax agencies employ this practice, but neither agency had information.
 - DRS lists the names of the top 100 delinquent taxpayers for the personal income tax on its website, but not delinquent taxpayers for other state taxes.

Recommendations:

- 5. The Department of Revenue Services shall study the impact of amending the statutes to require that any person or entity doing business with the state must be in compliance with state tax laws. The study should assess the methods that might be employed by DRS to provide verification of tax compliance to state agencies before issuing a contract or grant, as well as any anticipated legal issues that might arise including definitions of compliance and confidentiality, any anticipated delays in awarding of contracts, and an estimate of resources necessary for implementation.**

VIII. Principle: Accountable

A tax system should be explicit in how revenues are raised, changes should be well publicized, and the costs and benefits of tax policies should be examined.

Findings:

Accountability is strongest for the local property tax; state taxes are less transparent. The state has minimal capacity for tax policy research and little is known about the distribution of tax liability within Connecticut's revenue system or its component taxes. Tax system information that is available to the public is mostly collections statistics and scattered in a variety of agency documents.

- At the local level, taxpayers receive bills clearly showing the amount of property tax they owe, the process for determining assessments and rates is public, and in many towns, the local budget must be approved at a town meeting or by referendum.
- At the state level, it is difficult for taxpayers to know how much they pay directly and indirectly in state sales, excise, and various business taxes. Final legislative action on revenue and spending bills is public and legislative changes to the state taxes are publicized in print and electronic media. Connecticut's spending cap and balanced budget requirements provide some taxpayer accountability regarding the legislature's fiscal decisions.
 - DRS issues press releases about new and revised state taxes and includes detailed notices about tax changes on its website.
 - It appears the cap has been effective in helping to curb state spending growth and any related need for higher revenues. Connecticut's state government spending as a percent of either personal income or gross state product compares well with the national averages for these measures of state tax burden (7.3 percent versus 7.0 percent of personal income and 6.5 percent versus 6.0 percent in 2002, the most recent year with available data).
- Information about state and local taxes is produced and regularly reported by executive branch agencies including the Department of Revenue Services and the Office of Policy and Management, the Office of the State Comptroller, the legislative Office of Fiscal Analysis, and, regarding the property tax, all municipalities.

- However, there is no single, up-to-date source of even basic state and local tax collection statistics for Connecticut that is available to legislators or the general public.
- DRS is required by law to: report a variety of detailed tax payment data by type of tax and taxpayer categories to OFA each year; include in that annual report specific data on corporate tax payments and penalties; supply information on corporate tax exemptions and credits and other business tax-related issues needed by the newly established legislative business tax credit and tax policy review committee; and maintain a list of delinquent taxpayers that is available to the public.
 - As part of its statutory annual report to OFA, the department publishes a comprehensive statistical report on state taxes, similar to annual reports produced by most state tax agencies, that is available to the public. It includes revenue collections and numbers of taxpayers by type of state tax over time as well as data on sales tax exemptions, sales and real estate conveyance taxes by town, and aggregated information on corporate tax credits.
 - Due to the heavy demands from ITAS implementation on research staff resources, DRS has been unable to publish this annual report since FY 03.
- The Comptroller is responsible for issuing the official, audited statements of state revenues; problems with the state's new computerized accounting system (CORE-CT), however, have prevented final reporting for either FY 04 or FY 05 to date. At one time, the Comptroller did some economic analysis and reporting on state finances but that function was discontinued in 2003 due to agency staff reductions.
- OPM is responsible for overseeing the administration of the local property tax by Connecticut cities and towns. As part of that duty, it collects a variety of tax and expenditure information from all cities and towns and prepares an annual municipal fiscal indicators report.
 - By statute, OPM also reviews and certifies a variety of statistics concerning the quality of local assessment procedures. To date, that information has not been compiled and reported in a form available to the general public.
 - At present, OPM is the only centralized source for local property tax policies, procedures, and related data.
- Public information on tax expenditures, which are tax credits or exemptions intended to benefit certain taxpayer groups (e.g., low-income households, the ,

elderly or the disabled) or promote specific public policy goals (e.g. job creation, pollution abatement) enhances accountability.

- OFA, in addition to its main function of supporting the appropriations and finance committees in developing the state budget, is statutorily required to issue a report on state tax expenditures every two years.
 - At present, the OFA report is the only comprehensive source of information on the use of existing tax credits by individuals and businesses in the state and the data it includes is highly aggregated.
- The research office of DRS has a small staff and its role as defined by current top management does not include tax policy research. The resources within OFA and OPM available to carry out the revenue forecasting, long-term financial planning, and policy analysis including examination of the costs and benefits of tax changes are also limited.
 - At present, the DRS research office is staffed by three people, who also have legislative liaison duties in addition to their primary function of providing statistical information on state taxes to OPM and OFA for their revenue forecasting and tax change analysis functions. As noted above, over the past two years, the research office devoted much of its time to facilitating the agency's ITAS project implementation.
 - DRS expects full implementation of the agency's new ITAS system, specifically the data warehouse function scheduled to be in place by the middle of 2006, will vastly improve its research and reporting abilities. However, other than ensuring all currently required reports will be produced, nothing specific in terms of the research office's goals and objectives, major duties, or resource requirements has been planned or discussed at the agency.
 - OFA and OPM which have major responsibilities for tax policy research also have small numbers of staff assigned to their revenue functions (i.e., about the equivalent of four full-time analysts in each office), use private economic research services for assistance with these duties, and must rely on DRS to supply necessary state tax revenue data.
 - Bond rating agencies interviewed by the program review committee noted the positive characteristics of the most highly rated states (i.e., those with steady AAA ratings) include strong revenue analysis and research capabilities along with a commitment to long-term financial planning.

- Several recent legislative initiatives should improve both the quantity and quality of information about the state’s revenue system that is available to policymakers and the public.
 - Legislation enacted in the most recently completed session (P.A. 05-262) requires the appropriations and finance committees to meet annually in November to consult and receive “fiscal forecast” information from OFA and OPM, including short- and long-term revenue estimates and trends in spending, projected reserves, and debt burden.
 - The legislative committee established under P.A. 05-251, is responsible for evaluating corporation business tax credits and business tax policy changes according to specific criteria, including measurable economic development or state workforce benefits. The committee must also analyze each tax credit or policy change and recommend revisions for those found redundant, unnecessary, or insufficiently beneficial.
 - The current budget authorized funding to establish and maintain a multi-tax revenue estimating and forecasting system in the Office of Fiscal Analysis. An RFP to develop the system was issued by the Office of Legislative Management in October 2005 and an evaluation committee is currently reviewing the submitted proposals. Under the RFP, the system’s main functions would include: revenue forecasting; revenue estimates of proposed changes to current law; distributional and incidence analysis and data analysis; periodic analysis of the current tax structure and proposed changes to the major component taxes including the local property tax.

Recommendations:

- 6. DRS should take immediate steps to formally establish an agenda for its research office. It should begin this task by identifying, assessing, and prioritizing both currently required reports and projects and internal and external requests for new or expanded research products. Based on this assessment, DRS should also determine: the amount and type of staffing and other resources needed to effectively carry out its research agenda; the types and sources of data required; and how ITAS will be used to support these research efforts.**
- 7. Amend the statutes to require the Department of Revenue Services to include information on total local property tax collections each year for the most current five-year period available in its annual statistical report.**
- 8. The Office of Policy and Management should include in the municipal fiscal indicators report it publishes each year information on trends in local property values and taxes such as: the average and median single-family home tax bills and percent change in those amounts over time; town-by-**

town information on the availability and use of local option property tax exemptions; and measures that indicate the accuracy and uniformity of local revaluations (e.g., sales assessment ratios, coefficient of dispersion, price related differentials).

POLICY OPTIONS: ACCOUNTABLE	
Option Description	Implications
<p>A. Regular Tax Incidence Analysis</p> <p>Statutorily require the legislature every five years to: i) assess the state and local tax system in terms of the NCSL principles of a high quality revenue system; and ii) produce a tax incidence analysis report.</p>	<ul style="list-style-type: none"> • Periodic reporting on system's performance in terms of NCSL principles, particularly concerning the distribution of tax burden, would allow policymakers to regularly assess the cumulative impact of tax revisions as well as changes in the economy on the state's revenue system. • Better informed discussion of tax policy changes would be possible since incidence analysis provides detailed information on the distribution of tax liabilities across different income groups and types of taxpayers as well as the costs of proposed changes. • The research and analysis needed, especially for a tax incidence report, is relatively expensive, requiring dedicated staff resources and up-to-date software and databases. • Access to tax-related information deemed confidential by federal or state agencies may be a problem and limit the scope of analysis as well as its usefulness.
<p>B. Tax Change Impact Notes</p> <p>The impact of all legislative proposals for new taxes and major revisions to existing taxes should be assessed in terms of the NCSL principles for a high quality revenue system, and, prior to final action on any proposal, the results of this assessment should be available for legislative</p>	<ul style="list-style-type: none"> • Analysis of tax changes in terms of each revenue system principle would provide more information about costs and benefits of policy revisions and permit fuller discussion. • The analysis would increase awareness of the impact on the overall system of

POLICY OPTIONS: ACCOUNTABLE	
Option Description	Implications
consideration.	<p>changes in any component parts.</p> <ul style="list-style-type: none"> • The new function would require additional staff resources and would be best accomplished if those responsible had some background in economics and public finance. • The NCSL principles are not easily defined or quantified. Some of the evaluation required would necessarily be qualitative and it may be difficult to complete the complex analysis required within the time frame demanded by the legislative process.

IX. Principle: Fairly and Efficiently Administered

The provisions of a tax system should be easy to understand and implement and be uniformly applied. The proportion of revenues used to assess and collect taxes, enforce laws, and audit compliance should be minimized.

Findings:

Connecticut's personal income and sales tax provisions are relatively simple, making them less prone to errors and avoidance and easier to manage than the complicated state corporate income tax. The Department of Revenue Services operating budget accounts for a very small portion of total state tax collections, but the lack of good quality performance data make it difficult to assess the agency's administrative efficiency or effectiveness.

The following findings on Department of Revenue Services administration and operations are based on information and analysis contained in Section II.

- The state personal income tax uses federal adjusted gross income as a starting point, has few special credits and exemptions, and is easily processed electronically.
- The state sales tax is relatively simple to administer because it has a single rate and is the only general sales tax applied in Connecticut. Participation in the national Streamlined Sales Tax project could make enforcement easier and reduce administrative costs.
- The complicated structure and calculation of Connecticut's corporate income tax subject it to considerable legal and accounting interpretation about liability, making it difficult to administer.
- Electronic personal income tax filing rates at DRS are increasing each year, and Connecticut's rate is among the highest in the country. Automation of major tax functions like return filing, payment, and refunds improves agency efficiency by reducing errors, delays, and transaction costs.
 - The proportion of state personal income tax returns filed electronically in Connecticut was 67 percent for the 2005 tax season versus 48 percent for the U.S. on average.
 - All preparers who file over 200 Connecticut personal income tax returns are now mandated to file returns electronically.

- The department reports refunds for electronic filers are issued within four business days, while it can take up to eight weeks to process refunds for returns submitted in paper form.
- There are no established benchmarks for major tax functions or any centrally collected cost and activity data from other states, making it difficult to comparatively assess any of Connecticut's indicators of fair and efficient administrative performance. The measures of agency performance based on revenue collected that are regularly tracked by DRS management seem to reflect trends in the economy as much as administrative policies or procedures.
 - The DRS operating budget accounts for less than 1 percent of total state revenues collected each year. Between FY 00 and FY 05, agency annual expenditures including employee fringe benefits averaged \$77.3 million, while total revenue collections averaged \$9.7 billion per year.
 - Over a recent four-year period, the ratio of total revenues collected to DRS operating expenses including fringe benefit costs ranged from a low of \$116 in FY 02, the worst year of the state's economic downturn, to \$139 in FY 04.
 - The percent of state taxes collections voluntarily remitted dipped to 94 percent during the FY 02 recession, but has risen steadily since, and was 97 percent in FY 04. Voluntary remittance is only a rough proxy for the agency's primary goal of voluntary compliance, which is best measured by an analysis of "tax gap," the difference between total taxes owed and taxes paid voluntarily.
- DRS has taken a number of steps to improve its levels of customer service. The agency's Operations Division has maintained productivity levels for many tax processing functions despite workload increases and staff reductions.
 - Between 1998 and 2004, the Operations Division has consistently: resolved 90 percent of tax return errors within the quarterly filing cycle; issued more than half of all income tax refunds in five to 10 days; and issued 99 percent of all income tax refunds without being required to pay interest (i.e. refund issued within 90 days).
 - The department maintains a user-friendly website with up-to-date and fairly extensive state tax information including copies of tax forms, instructions for completing returns, and electronic access to tax laws, regulations and department policies. The DRS website is accessed an average of 202,000 times each month.

- The DRS Taxpayer Services Division operates a call center to answer questions from the taxpaying public throughout the year. During April, its busiest month, the center handles more than 16,000 calls. Division statistics for April from a recent three-year period show only a small fraction of calls are abandoned, and while fewer than half are answered within the high industry standard of 20 seconds, the majority are answered within one minute.
- Auditing is a crucial function to ensure taxpayer compliance. DRS has incurred losses of staff from layoffs and retirements in the Audits Division, and those have had an impact on productivity.
 - The composition of DRS audits and assessment amounts vary by tax type. For example, corporate audits make up only 2 percent of audits conducted, but account for 35 percent of the audit assessments.
 - Despite staffing reductions and a decrease in audit numbers, DRS still audits a greater percentage of personal income tax returns than the IRS.
 - While the number of DRS audits has decreased, the amount of assessment per audit conducted has increased, perhaps indicating the use of a better audit targeting strategy.
- DRS statistics show a low percentage of audits are appealed, but the time to close an appealed case seems long. On average, audit assessments that are appealed by taxpayers tend to be significantly reduced.
 - Between 1 to 1.5 percent of audits are appealed by taxpayers.
 - Over half of the appeals cases are more than a year old when closed by the Appellate Division.
 - The Appellate Division reduces the amount of audit assessments by more than half, on average.
 - The interest rate charged taxpayers on assessments under appeal is set in statute at 12 percent. That rate appears high (e.g., higher than the IRS and Massachusetts) and has not been changed since 1995.
- Like other parts of the agency, the Collections and Enforcement Division has incurred staffing reductions but the impact on productivity could not be assessed. Information on trends in performance was not available since measures of division's compliance activities reported under a prior computer system are not produced by ITAS.

- DRS has been working since 1994 to upgrade its automated systems and develop one high quality, integrated computer system for all of its tax administration functions. The new system, ITAS, has experienced cost overruns and delays, but implementation is actively underway at this time and is expected to be completed by the end of 2006.
 - Integrated taxpayer registration, return processing and accounting functions for all business taxes are up and running.
 - Development of similar functions for the personal income tax is in progress and estimated to be operational in July 2006.
 - The last phases of the project that will automate a variety of internal management activities, including audit selection, appeals processing, and data warehouse functions (to support compliance programs and research); automation of many customer services (e.g., taxpayer “self-service” options and on-line help) is targeted for completion in September 2006.
- There is an overall lack of management information within DRS that seriously impedes the agency’s ability to identify where performance improvements are needed as well as opportunities for greater efficiency.
 - ITAS is admittedly “management report poor” and unable to capture performance information that was available from prior systems. It is now more difficult to track efficiency and effectiveness of operations, enforcement, and compliance functions.
 - The main overall agency performance measures the commissioner of revenue services tracks cannot be produced by ITAS at this time. The agency has no clear plan or formal mechanism in place to develop an administrative performance measurement system.
 - While agency managers anticipate the ITAS data warehouse function will be able to provide quality management information and permit better research, this capability has not been examined or evaluated to date. The current goal is to get ITAS in place and then determine what research and management reporting functions are needed.
 - DRS does not currently capture data submitted on personal income tax returns that would help with analysis of the distribution of tax burden (e.g., reported local property tax payments) or that would be useful to audit staff (e.g., overall income of pass-through entities).
- Preserving confidentiality of taxpayer information and internal security control is a high priority within DRS.

- A taxpayer bill of right exists in statute that guarantees the rights, privacy and property of Connecticut taxpayers will be safeguarded and protected. While it is included as a link on the agency website, it is not easily found.
 - DRS conducts background checks on all potential employees, requires its employees to sign confidentiality agreements, and only shares its data with other state agencies in accordance with similar confidentiality agreements. Its Internal Audit Division monitors employee practices to preserve taxpayer privacy and disciplinary actions are taken when breeches of confidentiality occur.
 - DRS uses the Internal Revenue Services guidelines for safeguarding federal tax return information, but appears to use an extreme interpretation of “return information” in responding to data access requests for state tax information.
- DRS has not established long-term, quantitative goals or mechanisms for measuring progress in meeting them as would be consistent with a results-oriented management approach.
 - DRS has no up-to-date strategic plan, no resources specifically assigned to planning functions, and does not expect to begin any strategic planning efforts in the near future.
 - Research and planning capacity in the agency is limited. The agency’s three-person research office also has responsibility for legislative affairs. Over the last two years, significant staff time has been allocated to ITAS implementation matters.

Recommendations:

- 9. DRS should formally establish an internal working group to: i) identify agency-wide management information needed from ITAS; and ii) coordinate and oversee development the system’s ability to track and report performance measures. The group should ensure ITAS will collect and produce data that allow monitoring of key activity trends and outcomes and consider including a capacity to track selected benchmarks developed by the Federation of Tax Administrators.**
- 10. DRS should assign agency resources to develop and maintain a current strategic plan for accomplishing its mission and goals.**
- 11. The statutes should be amended to lower the current interest rate, or at least the rate charged on cases under appeal, to the same rate the IRS uses, which is the federal short term interest rate plus 3 percent. DRS should update the rate quarterly based on changes in the IRS rate.**
- 12. The homepage of the DRS website should prominently display a link to the agency’s description of the Connecticut’s “Taxpayer Bill of Rights.”**

Administration of Connecticut Taxes

Any tax policies a state adopts need sound administration to ensure:

- fair implementation;
- prompt and clear communication to the public;
- efficient revenue collection;
- administrative opportunities for taxpayers to appeal a tax bill; and
- enforcement against those who attempt to avoid paying taxes owed.

In Connecticut, administrative functions for all state taxes are carried out by the Department of Revenue Services. This section provides additional information and analysis about Connecticut tax administration, much of which is the basis for the discussion of the last principle about fairness and efficiency in Section I. The October briefing report indicated that further information in this area would be developed and presented in this final report. Specifically, this section provides a brief summary of the current DRS organization and resources and a description of overall agency performance, as well as activities in Operations, Taxpayer Services, Audit, Collection and Enforcement, and Appellate Divisions. The current status of the agency's ITAS system is also discussed.

An analysis of department workload and outcome measures, where available, along with an assessment of agency performance in terms of efficient administration and promoting compliance are provided in this section. It was neither the intent of the committee, nor feasible within the scope and resources of this project, to conduct a comprehensive performance audit or "typical" program review of DRS. Further, drawing any conclusions about how well DRS administers state taxes is problematic for a number of reasons, which are discussed in greater detail below. In general, administrative efficiency and effectiveness measures, when they are discussed, are broad indicators, not precise gauges, of agency performance.

Limitations in Assessment

To complete this part of the study assessment, committee relied on what workload and performance measures the Department of Revenue Services provided. In some areas, department management tracks broad indicators such as revenue collected as a ratio of agency operating expenses and staffing over time. In a few selected areas related to customer service, the department measures and tracks its performance against some standards. But, for the most part, the committee relied heavily on the activity measures that DRS reports for the governor's budget, but those are only produced for the initial year of the biennium. The department was able to develop and provide additional information in some areas at the committee's request but follow up frequently took months indicating the data are not produced and maintained by DRS on an ongoing basis.

Comparative data from other states are not available in a centralized source, making any comparative analysis extremely difficult. While annual reports, performance audits, and sunset studies of selected other state tax departments often contain detailed information on major tax functions, wide variation in state tax structures, organizational frameworks, and budgeting limited their use for comparative purposes. A national benchmarking project being conducted by the Federation of Tax Administrators, which is intended to develop and report on performance standards for state tax agencies, is still in its initial stages, and no data can be provided for state comparison.

Second, the department, like most state agencies, has seen its staffing reduced considerably through layoffs during late 2002 and early retirements in 2003. While the agency has been given authorization to refill some of these positions, it will be some time before the new hires or transfers are at optimal productivity to the agency. This instability in staffing makes it difficult to assess the department's workload efficiency over time. It appears that some divisions have been able to cope better than others with the staffing losses and efficiency has not declined; in other units, productivity has been impacted.

Third, the new computerized system DRS is implementing to replace its antiquated mainframe systems has become an all-consuming priority for department staff. While recognizing that it is imperative to have the Integrated Tax Administration System (ITAS) become operational, the staff resources dedicated to the system's implementation have limited the department's ability to complete other tasks, and at least temporarily impaired DRS data collection and reporting capabilities.

Additionally, the ITAS system is not yet producing management information and some indicators collected under previous DRS computer programs are not and will not be captured by the new system. On-going implementation of CORE-CT, the statewide automated system for all agency accounting functions also complicates evaluation of personnel and budgeting matters in every department including revenue services. In fact, final financial statements for Fiscal Years 04 and 05 have yet to be issued by the Comptroller's office because of outstanding accounting issues related to the CORE-CT system.

AGENCY ORGANIZATION AND RESOURCES

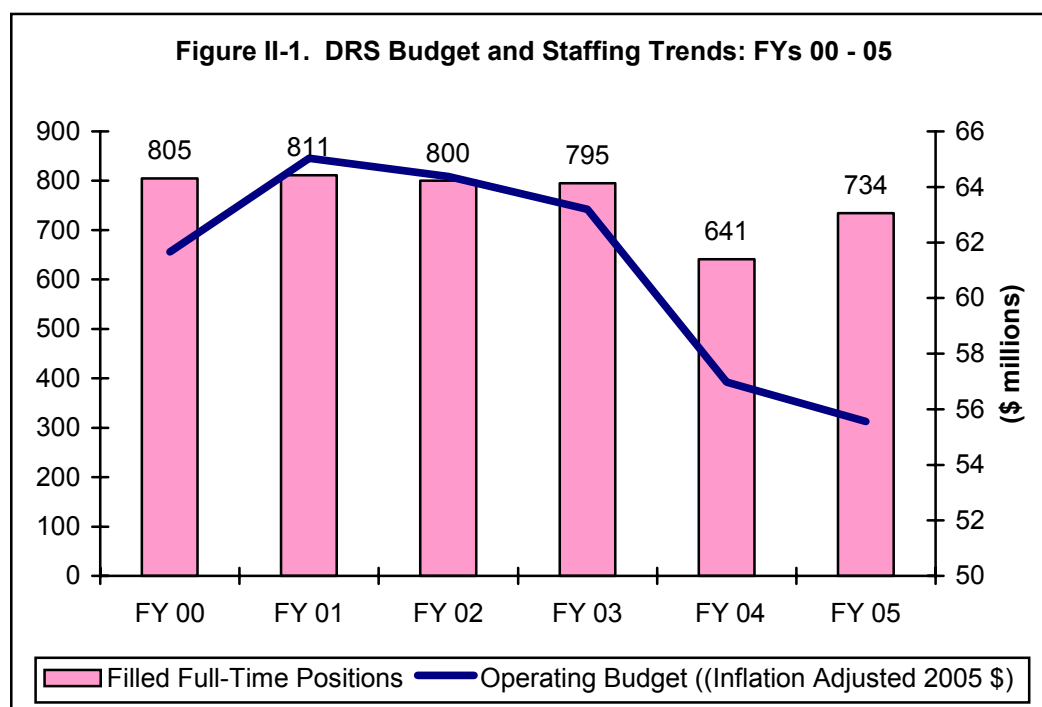
At present, the Department of Revenue Services is organized into four major program areas:

- management services, which encompasses all of the agency's executive, legal, research, administrative support, and taxpayer services (e.g., public education and information) functions;
- operations, which covers all tax processing as well as information services;
- audit/compliance, which carries out all office and field audit activities; and
- collections and enforcement, which includes activities related to taxpayer outreach e.g., mailing overdue notices, establishing repayment schedules), enforcement, and criminal investigations.

Taxpayer appeals, including any court-related matters, are handled by the Appellate and Litigations divisions within management services. Another part of management services, the Office of Planning and Organizational Development (OPOD), includes the agency's relatively new internal audit division and is responsible for security control and overseeing agency-wide projects (e.g., the current effort to transfer from paper to electronic filing, ITAS implementation).

As discussed in the committee October 2005 briefing report, adequate resources are critical to efficient and effective tax administration. Successful performance of a tax agency's major functions – assessing and collecting taxes, enforcing tax laws, and auditing tax compliance – depends on both the number and quality of its personnel and an up-to-date, high-quality automated information system.

The briefing report showed since FY 00, DRS has been characterized by essentially flat-funding of its operational budget, which has meant declining dollars when adjusted for inflation, and significant staff reductions due to layoffs and early retirements. (See Figure II-1.) In some years, even revenue-producing positions (e.g., tax examiners in the audit and collection units, appellate staff) were eliminated or not refilled as part of required DRS budget cuts, which had to be carried out in accordance with collective bargaining agreements, during the state's fiscal crisis. The department has recovered a number of its lost positions over the current and just completed fiscal years, but remains below its peak staffing level.



The agency's main mission over the last 18 months has been, and will be for at least another year, getting its entirely new integrated computer system, ITAS, in place and operational. In fact, the top priority for almost every DRS employee has been the timely and successful implementation of ITAS. Automation improvements made possible under ITAS (described more fully later in this section) should permit greater administrative efficiencies

through the electronic processing of most tax transactions as well as more efficient and effective auditing and collection procedures.

Funding for the ITAS project was essentially unaffected by recent agency budget cuts but many familiar with the agency believe the loss of a number of experienced staff due to early retirements in the midst of final development contributed to delays in its implementation schedule. The impact of staff reductions, along with the allocation of resources to ITAS implementation, can be seen in some of the activity statistics described later in this section but generally is not evident in broad measures linked to total revenue collections. According to DRS, this is at least partly because when cuts were made, remaining resources were allocated first to the agency's highest priorities such as voluntary remittance and timely processing, which are activities reflected by total collection numbers.

Automation improvements occurring with the phase-in of the new system may also have helped sustain levels of employee productivity in return processing and some collection-related functions. In contrast, lower priority functions, such as follow-up on accounts receivable files or hearings on appeals, clearly had drop offs in performance coincide with decreased staffing. As noted earlier, any firm conclusions about the reasons behind most trends in DRS administrative performance would require more in-depth analysis of staffing patterns and outcomes by function than is possible within the scope of this study.

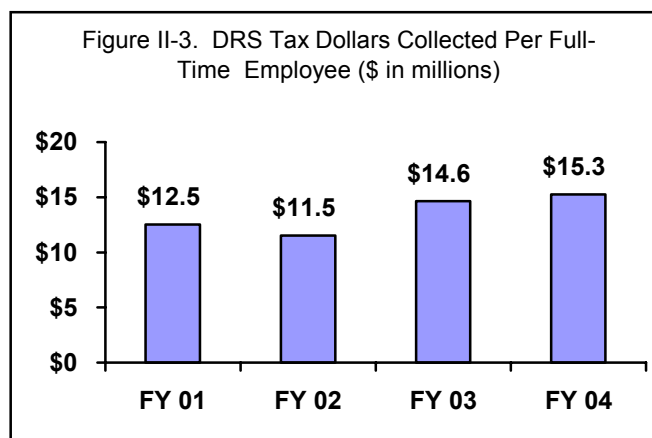
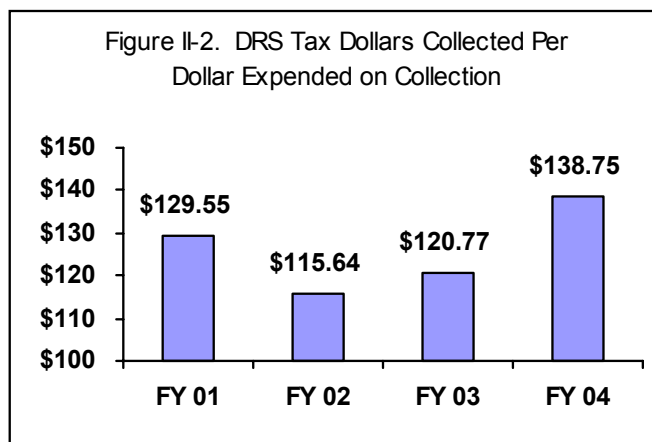
Overall Performance Measures

In response to a program review committee request, DRS provided several broad statistics on overall agency performance for four recent fiscal years. The four types of performance indicators discussed below are the main measures the current commissioner uses to review agency administration with top managers each year. The measures are best used to examine general trends and identify where additional research may be needed as they show year-to-year changes, but provide little insight into the reasons for fluctuations. Furthermore, the jumps and drops in state revenue collections appear to be more strongly related to economic cycles than particular tax administration policies or procedures.

Collections versus costs. One indicator some states use to track overall tax agency performance is a comparison of revenues collected to the costs of collection, or what sometimes is referred to as "return on investment." This measure is calculated in several ways, including tax revenues collected per dollars expended (e.g., the agency operating budget) and the ratio of revenues collected to personnel costs or the number of full-time employees. The program review committee tried to gather cost-to-collect statistics from other states but found there were too many differences in the structures of their tax systems, as well as in their organizational structures and scope of functions, to allow for reliable comparisons.

Two revenue-to-expenditure measures DRS tracks are presented for four recent fiscal years (FY 00 – FY 04; FY 05 data are not available for these or other overall measures because of ITAS conversion issues) in Figures II-2 and II-3. Basically, the trends in both dollars collected per dollar spent and total dollars collected per employee mirror the impact of the

economy on Connecticut's state tax revenues.²³ Both measures were at their lowest when the recent recession was at its worst in FY 02; both measures have risen as the economy has improved and the agency's budget has stayed about the same.

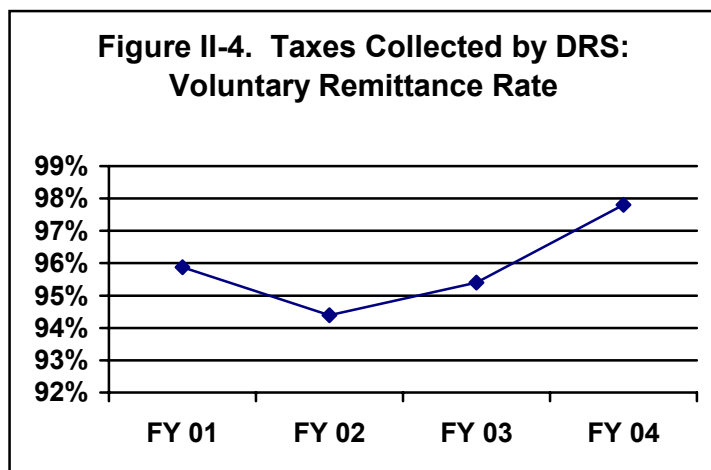


Voluntary compliance. A high rate of voluntary compliance, the extent that taxes owed are paid accurately and on time without the need for collection or enforcement actions, is the common chief goal among tax agencies. In a broad way, it may indicate taxpayer confidence in the fairness and effectiveness of the system. It may also reflect the effectiveness of public education efforts. As might be expected voluntary compliance rates also vary with the economy, tending to dip during downturns when some taxpayers have less ability to pay what they owe on time or in full.

DRS regularly tracks the portion of state tax collections that are remitted voluntarily (paid without state compliance efforts) and involuntarily (paid as the result of collection and enforcement actions). According to the agency, the portion of total tax collections remitted voluntarily in Connecticut is more than 90 percent every year and the rate reached a high of 97

²³ Figures for Figure II-2 were calculated as total revenues collected by DRS divided by reported agency operating costs plus an estimate for employee fringe benefits expenses; for Figure II-3, total revenue collections were divided by the agency's reported number of filled full-time equivalent positions.

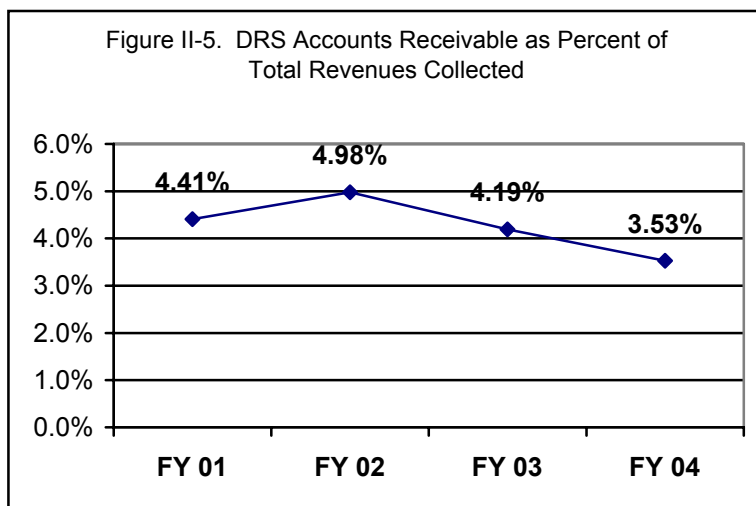
percent in FY 04. As Figure II-4 shows, in recent years the rate was lowest for FY 02 when economic times were hardest in the state.



Voluntary remittance is most useful for monitoring internal trends in the agency's collection efforts and is only a rough proxy for voluntary compliance. This is because it only measures the portion of total tax dollars collected, not the total amount of taxes owed, that is paid voluntarily. Also, the rate could improve for any number of reasons ranging from better public education efforts to less effective compliance programs that result in lower involuntary collections. Ideally, this statistic

should be examined in conjunction with other compliance performance measures such as taxpayer error rates and dollars collected per tax audit hour to fully evaluate effectiveness in promoting voluntary compliance.

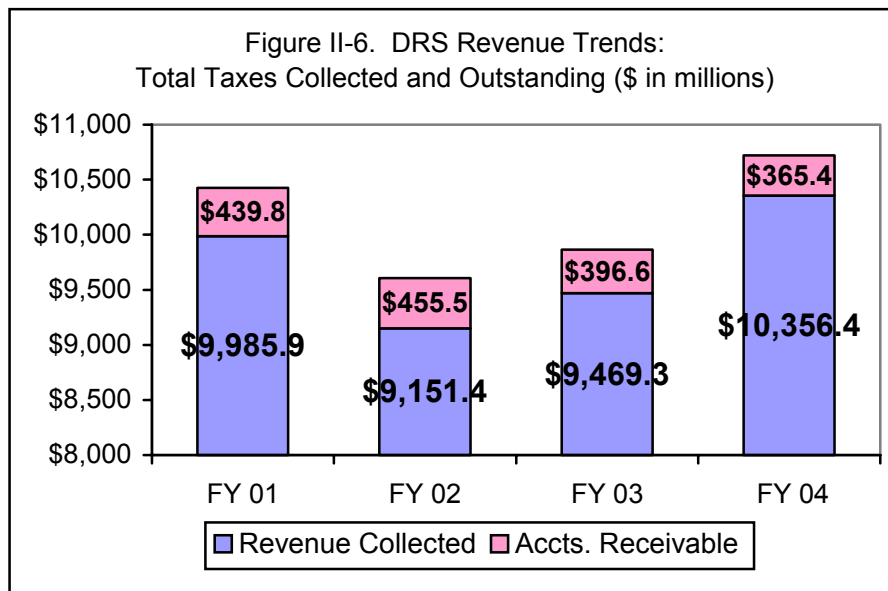
Taxes owed versus taxes collected. Another way to broadly evaluate tax agency effectiveness is to compare revenues collected with total payments outstanding or accounts receivable. The best measure of success in achieving taxpayer compliance, as described earlier in Section I, is a state's tax gap. However, estimating tax gap, which is the difference between total tax liability and the amount of taxes paid voluntarily, is such a complicated process that few



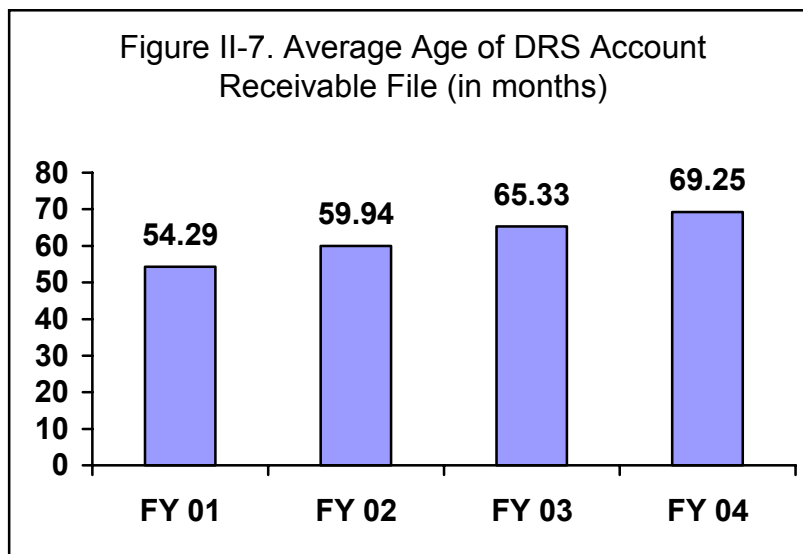
states including Connecticut regularly compute it. A simpler way a number of states monitor taxpayer compliance trends is by tracking the size of their accounts receivable, which is revenue owed after audits and other review of tax payments.

Figure II-5 shows total accounts receivable as a percent of total revenues collected by DRS each year from FY 01 through FY 04. The rate ranged from nearly 5 percent in FY 02, the worst year of the state's latest recession, to about 3.5 percent in FY 04. As might be predicted, accounts receivable were at their largest (almost \$456 million), and collected revenues at their smallest (\$ about \$9.2 billion) when the state's economy was at its lowest point (FY 02). As illustrated in

Figure II-6, collections had grown to more than \$10 billion in FY 04 while outstanding tax payments owed had shrunk to about \$365 million.



DRS top management monitors the “age” of its accounts receivable cases as well as the trends in total outstanding revenues owed. While payments owed as a portion of total revenue collections has grown smaller in recent years, the average age of accounts receivable has been increasing, as Figure II-7 indicates.



Over the four year period, the time an account receivable case has been open has grown steadily and substantially, from about four and half years to nearly six years. DRS officials told the program review committee the primary reason for this trend is a reduction in staff resources available for accounts receivable functions. The statistic, which does not take into account the

dollar value of cases, may be reflecting the department's decision to allocate available staff to the outstanding accounts with the largest payoff, meaning the many lower value cases will remain open longer.

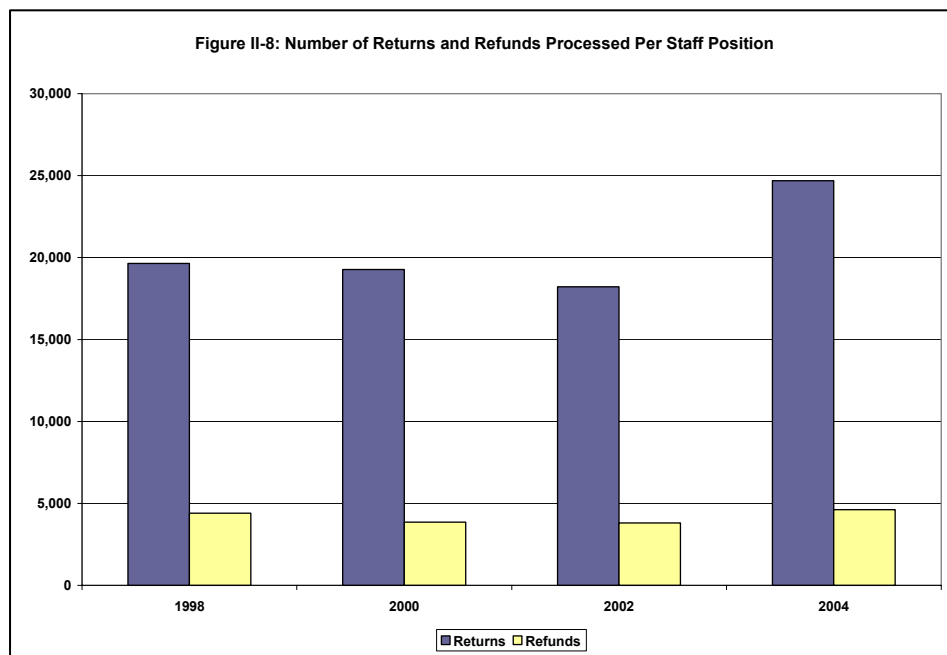
OPERATIONS AND TAXPAYER SERVICES

The Operations Division is responsible for ensuring efficient revenue collection. The Taxpayer Services Division ensures prompt and clear communication to the public. These important functions impact the reliability, accountability, compliance, and fair administration of the states tax system by DRS.

The Operations Division is responsible for processing and depositing the revenue from taxpayer returns, verifying timely issuance of refunds, creating bills for delinquencies, and developing reports based on tax collection revenues. The division also develops tax forms and publications, enters data, and issues permits, licenses, motor carrier decals, and tax registration numbers. The division collects more than \$9.5 billion in tax revenue annually and verifies the information presented on more than 5,000,000 returns for a variety of taxes annually.

Staffing for the operations division remained constant at 275 from FY 98 to FY 00. It experienced an increase of five additional personnel between FY 00 and FY 02, but between FY 02 and FY 04 the division experienced a loss of 55 filled positions.

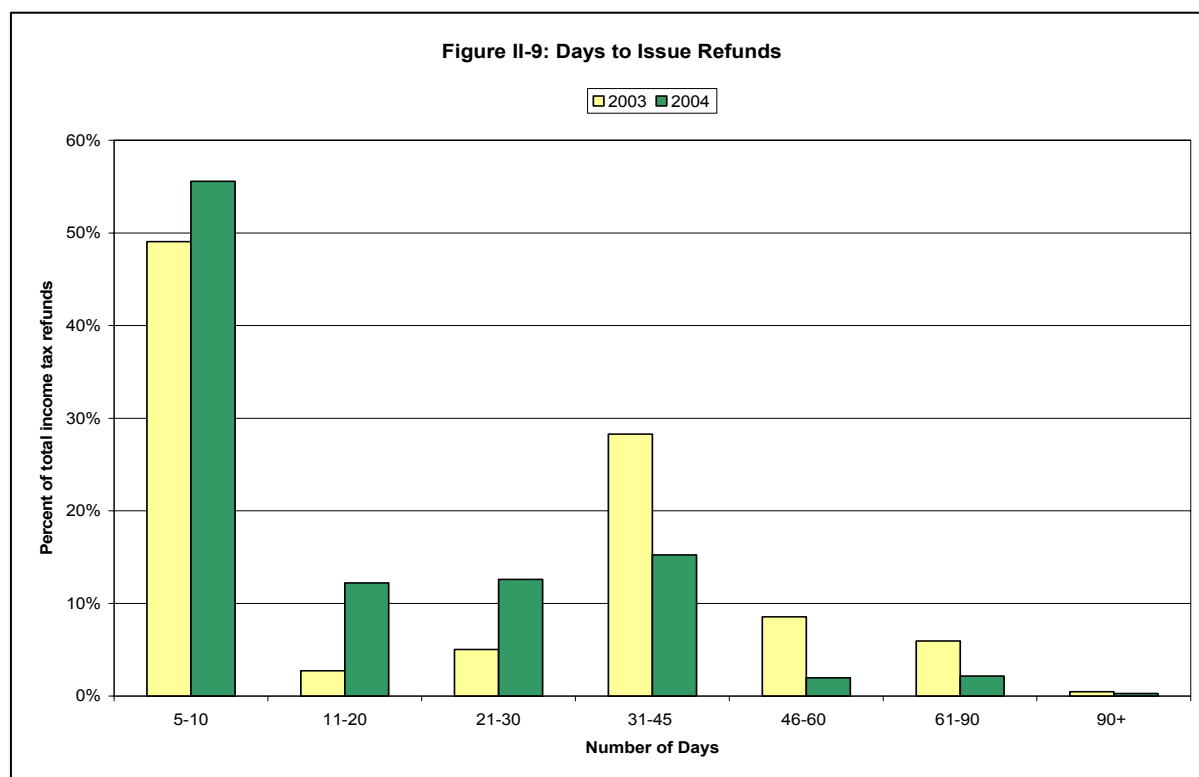
Returns processed. Figure II-8 illustrates the trend in the number of returns processed each year as well as the number of refunds processed per filled staff position for each year



provided in the governor's budget from FY 98 to FY 04. The average number of returns processed annually was 5,338,750. The number of returns processed per staff person increased by 26 percent between FY 98 and FY 04.

Although the return workload increased according to DRS data, during the FY 98 – FY 04 period examined, the division has consistently resolved 90 percent of tax return errors within the quarterly filing cycle.

Refunds processed. The total number of refunds processed for all types of taxes between FY 98 and FY 04 was 4,377,808. As figure II-8 illustrates, refunds processed per staff position increased by 5 percent between FY 98 and FY 04.



The increase in efficiency exhibited in both returns and refunds processed is likely due to the successful implementation of electronic filing, which requires fewer staff and financial resources. The trend for electronic filing is fast growing, as nationwide, 54 percent of all state income tax returns in the 2005 tax season were submitted electronically; in Connecticut the rate was 67 percent.

According to DRS, in FY 05 it processed a total of 996,000 returns electronically while 1,940,000 returns were filed on paper. The cost to the department per electronic return is approximately \$0.46, including contracting costs as well as human and information technology support services. The cost per paper return was not provided to the committee. As of January 2005, Connecticut is one of 13 states that now require tax return preparers to file returns electronically.

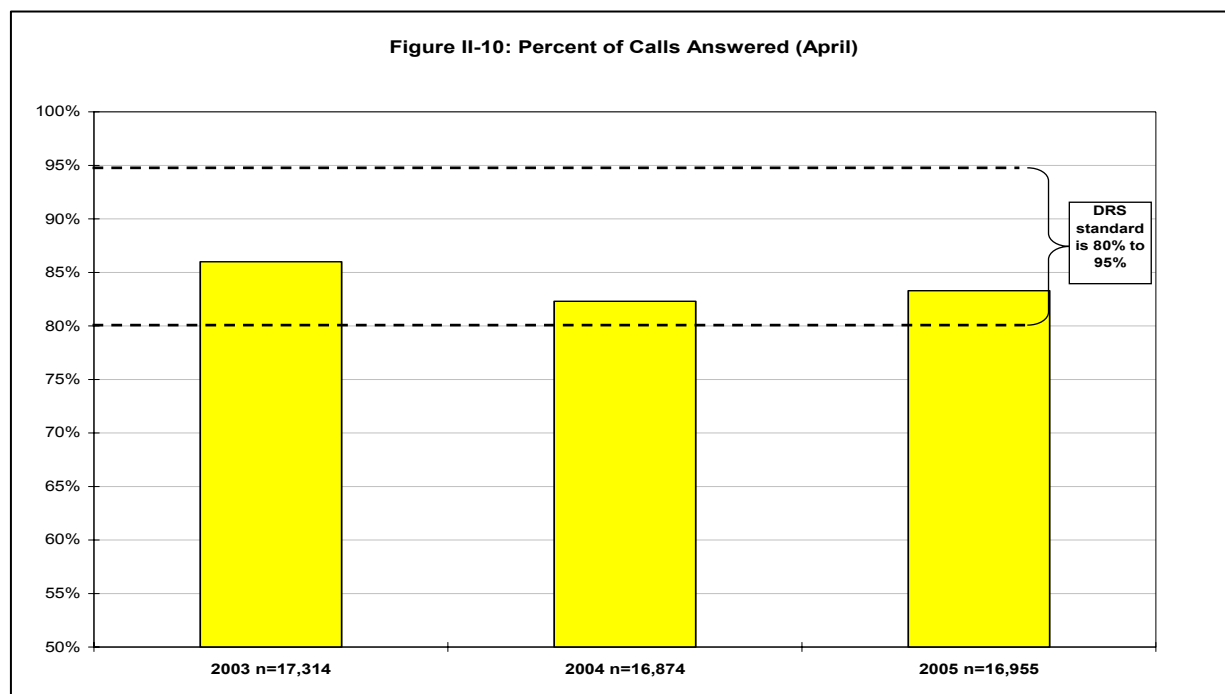
Refunds issued. Increased efficiency was also noted with the timeliness of issuing income tax refunds. Between FY 03 and FY 04 the number of income tax refunds issued within five to 10 days increased by 84,995. As Figure II-9 shows, this means that 56 percent of all income tax refunds were issued within this time frame in FY 04, up from 49 percent in FY 03. Overall, income tax refunds were issued more quickly in FY 04 than in FY 03. The operations division has maintained a constant rate of 90 percent for the amount of all tax refunds being

issued without earning interest, which must be paid at the rate of two-thirds percent per month on refunds issued more than 90 days after a return is filed or due (whichever is later).

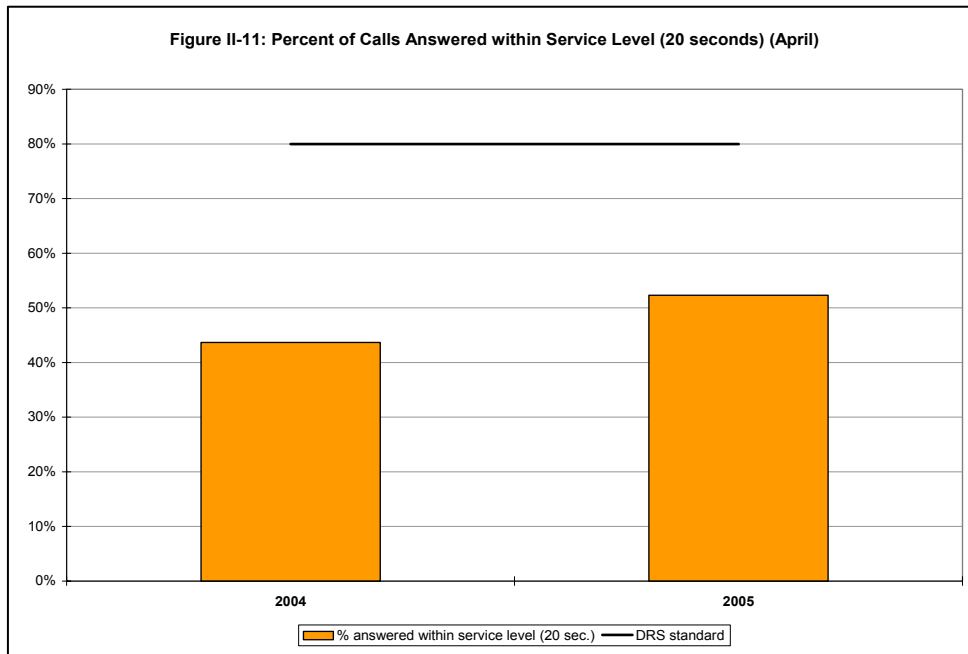
Despite decreases in both budget and staffing levels, the Operations Division appears to have managed its resources well through successfully implementing electronic filing and prioritizing responsibilities like refund processing. By maintaining their standard of timeliness and avoiding unnecessary expenses due to interest the division minimized the financial impact that decreases in staff can have on state revenues.

Taxpayer services. The Taxpayer Services Division maintains five field offices and a call center, through which DRS provides public education and information, responds to taxpayer inquiries, assists with applications and returns, and offers speakers for organizations and businesses. DRS regularly compiles call center statistics including quality of service standards established by a blend of customer service industries such as call volume and category (e.g., income, sales, or corporate tax) to monitor call center performance. DRS provided the committee with these statistics for 2003 through 2005. Using the month of April as a point in time for year-to-year comparisons, the committee calculated the average for this month each year for calls regarding the major state taxes. The program review committee assessed the performance of the call centers against the standards provided by DRS for each statistic.

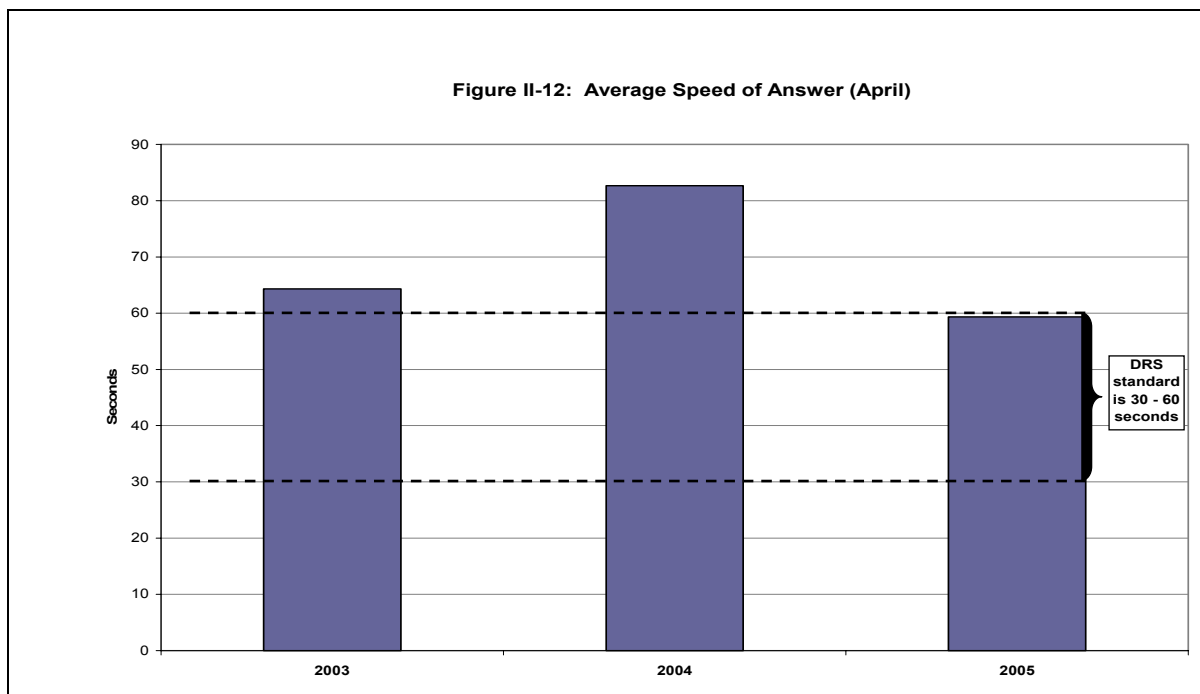
The committee found that over the three-year period the call center handled over 16,000 calls, on average, during the month of April. Each April, between three and five percent of the calls received are abandoned, while the percent of calls answered ranged from 86 percent to 82 percent. As shown in Figure II-10, this falls on the lower end of the DRS standard to answer between 80 and 95 percent of the calls.



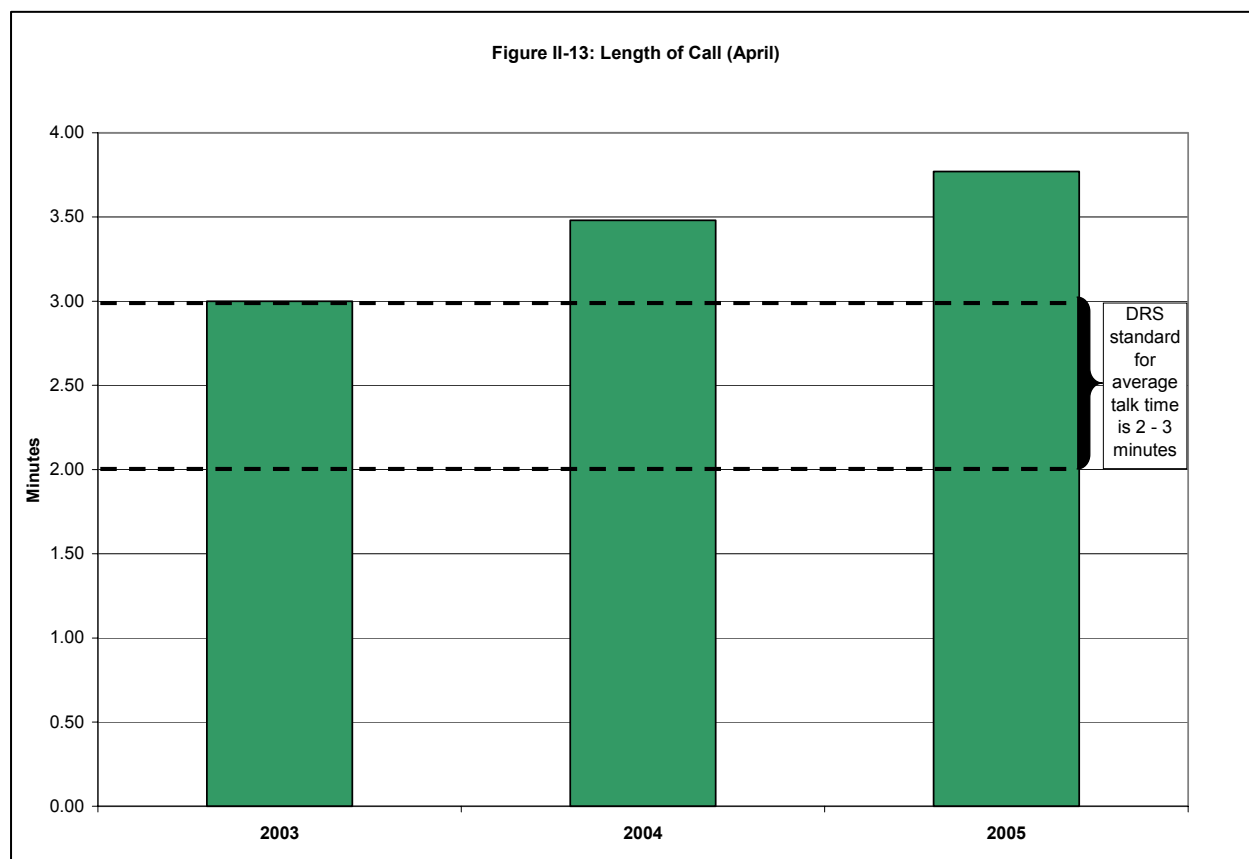
The committee examined the percent of calls answered within a specified service level measure -- the ability of the call center staff to answer calls within 20 seconds, which is a standard for phone service quality used across several customer service industries. The department's goal is to answer 80 percent of the calls received within this time. As figure II-11 illustrates, in the month of April about half of all calls met the "20 second standard." (Data were not available from the department for 2003.)



For those calls that cannot be answered within 20 seconds, the call center aims to keep callers waiting no longer than 30 to 60 seconds. For the three-year period presented in Figure II-12, the call center was able to meet this goal in April of 2005 and was close in April 2003.



Once answered, the department's standard for the length of a call is between two and three minutes. The program review committee found that over the last three years the length of each call has been slightly increasing. Figure II-13 shows average "talk time" grew from three minutes in April 2003 to almost four minutes in April 2005. However, without more information about the calls, such as the subject involved (e.g., type of tax, complexity of the question), as well as staffing levels, it is difficult to pinpoint reasons for the increasing length of call time.



Overall, it appears the call center receives a high and relatively steady volume of calls each April. While fewer than half of the calls are answered within the 20-second industry standard, the majority of the calls are answered in a little over one minute, and only a small fraction of the calls are abandoned. Given the predictability of the call volume and the trend toward increasingly longer calls, the call center may have to reassign staff from other areas to meet their quality of service standards during what is notoriously one of the busiest months of the year for the department. DRS is currently working on consolidating staffing and several other options to improve performance of the call center function.

COMPLIANCE AND ENFORCEMENT

Taxpayers must feel confident that taxes are fairly administered – that others are paying what is owed, and enforcement measures are taken against those who do not comply. At the same time, if persons believe they are being taxed unfairly, they must be given an opportunity to appeal. The department's efforts in these areas are discussed below.

Audit Division

The Audit Division determines the accuracy of tax reporting through field and office audits of targeted accounts. The unit consists of seven field audit units. Staff develop both computerized and manual audit selection strategies and maintain a centralized automated program to develop pertinent audit and statistical information. That system is being replaced by ITAS.

Staffing. As noted in the briefing report, DRS incurred a decline in staffing of about 20 percent during FY 03 and FY 04, due to the state employee layoffs and early retirements. Some of the positions have been refilled in FY 05, and additional positions were authorized in the FY 06 budget.

The audit division, like the rest of DRS, was impacted by the staffing reductions. The unit had 310 filled positions in FY 00; by FY 04 the filled positions totaled only 268, a reduction of 13 percent. By February 2005 the number of filled positions had increased to 277, and another 13 positions were authorized for FY 06.

Audits conducted. DRS provided program review with the number of audits conducted annually From FY 03 through FY 05, the three-year average, and projected for FY 06. The audit activity, by type of tax, is shown in Table II-1. As the table indicates, the number of audits conducted has declined about 31 percent since FY 03.

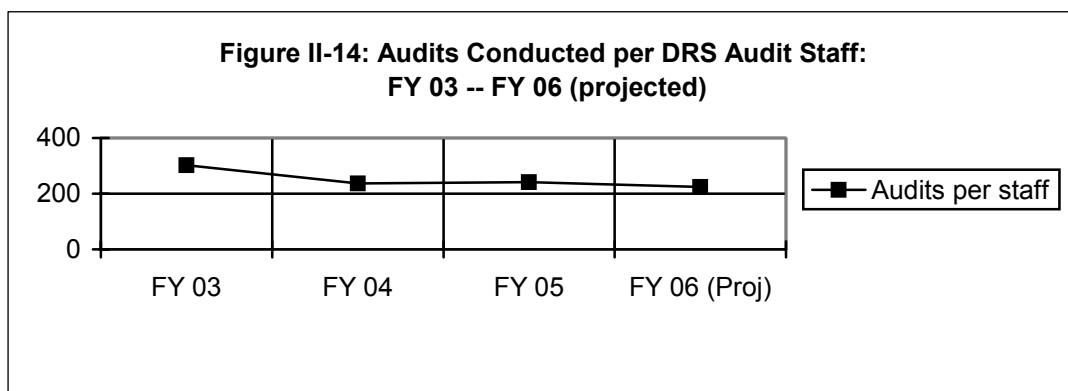
Table II-1. Summary of DRS Audit Activity FY 03 -- FY 06 (projected)					
Unit(Tax Type)	FY 03	FY 04	FY 05	3-year average	FY 06 (proj)
Sales and Use	5,159	4,566	4,777	4,834	2,150
Corporate Income	2,112	1,904	1,898	1,972	1,950
Personal Income	39,639	20,316	24,560	28,171	28,000
Total – income	42,781	22,398	29,834	31,701	29,950
Excise/Public Service	44,204	36,397	32,398	37,666	33,000
Total – All Taxes*	92,234	63,361	67,009	74,201	65,100
Source of Data: Department of Revenue Services					
*Total – All taxes is greater than the sum of each type because a number of audits are conducted by division's Discovery Unit but not always specified by type.					

Although DRS audit numbers have decreased, it is still auditing almost 1.5 percent of all returns filed, and more than 2.1 percent of personal income tax returns. The ratio of personal returns audited is higher than the federal IRS, which overall audits less than 1 percent, but does audit about 1.6 percent of filers with incomes of \$100,000 or more. The IRS plans to focus its audits on returns that appear to use “abusive tax shelters,” (i.e., those that include transactions

with no real economic purpose other than dodging taxes).²⁴ DRS was given additional authority by legislation enacted in 2005 to assess additional penalties for these detected abusive tax shelters as well.

Certainly the loss in staffing in the unit is a contributing factor to the overall decline in the number of audits. In other units in DRS, individual productivity increased for the individual staff remaining. However, that is not the case in the Audit Division, and, as Figure II-14 indicates, the individual audit workload for remaining staff actually decreased since FY 03. There are a number of probable contributing factors for this declining efficiency in per-worker productivity:

- The department is in the process of implementing an entirely new computer system, ITAS, which has been delayed and taken more staff time to oversee than originally anticipated. This detracts from day-to-day operations like conducting audits.
- The operational disruption of staffing reductions is probably not a one-for-one decline in productivity. In other words, while the organization attempts to adapt to less staffing, the workers who remain may not maintain their previous productivity level. Also, those left behind with the most experience might take over large, complex cases, thereby reducing their output.
- While the staffing in audits has gained back some of its lost positions, most of these persons are new to the units, if not the department. It will be a period of time before these people are fully trained and at optimal productivity.



Audits by type. As shown in the table above, the number of audits conducted varies considerably depending on the type of tax. Using the three-year average as a base, the percentage of the total audits conducted by type:

- 7 percent were in sales and use tax;
- 2 percent were in corporate income tax;
- 38 percent were in personal income tax; and

²⁴ Associated Press article, *IRS to Increase Audits Next Year*, November 28, 2005.

- 50 percent in excise and public service tax areas.

Areas that have not been a focus of DRS auditing in the past has been personal income tax withholding by employers, and small business and self-employed taxes. In fact, when the committee asked to get the number of persons who file exempt status for withholding taxes, DRS indicated its systems did not keep aggregate information such as that, but it will have that capability in ITAS. In the 2007 budget, DRS received funding to hire 20 revenue examiners and two systems developers to increase audits in these areas.

Audit results. One of the outcomes of an audit may be that the auditor finds the taxpayer owes more in taxes than the amount declared. In that type of case, the auditor makes an assessment of what the amount of tax liability should be. The total audit assessment amounts by type of tax are shown in Table II-2. As shown in the table, the amounts assessed from audits have declined since FY 03, a 27 percent reduction in FY 04 and an 8 percent reduction in FY 05.

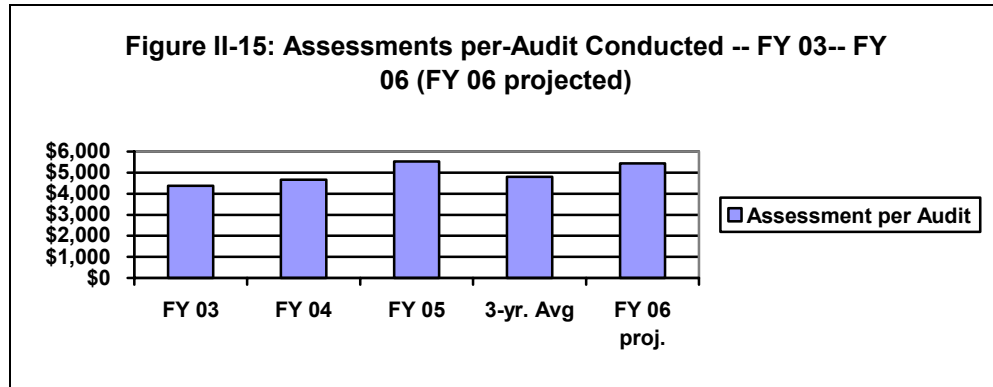
Table II-2. Summary of DRS Audit Assessments FY 03 – FY 06					
Unit (Tax Type)	FY 03	FY 04	FY 05	3-year average	FY 06 (proj)
Sales and Use	\$129,526,302	\$108,005,572	\$114,142,269	\$117,224,714	\$117,000,000
Corporate Income	\$154,778,854	\$88,998,767	\$125,313,493	\$123,030,372	\$123,000,000
Personal Income	\$64,796,330	\$51,124,279	\$85,448,741	\$55,497,586	\$67,000,000
Total – income	\$224,305,335	\$140,360,823	\$210,811,381	\$191,825,846	\$190,000,000
Excise/Public Service	\$49,611,495	\$47,049,111	\$45,083,517	\$47,248,041	\$47,000,000
Total \$ – All Taxes	\$403,443,132	\$295,415,506	\$370,037,167	\$356,298,602	\$354,000,000
Source of Data: Department of Revenue Services					
*Total \$ for All Taxes is greater than the sum of amounts for types, because of a amounts of assessments resulting from Discovery Unit audits, but not always specified by type of tax.					

Audit results by type. The committee also analyzed assessments by type of tax area using the three-year average. The results indicate:

- 33 percent of overall assessments were in sales and use tax;
- 35 percent of assessments were from corporate income tax audits;
- 16 percent of assessments were in personal income tax; and
- 13 percent of assessments resulted from audits of excise and public service taxes.

The ratios on assessments are almost opposite the ratios on the number of audits conducted. For example, while corporate and sales taxes are a small percentage of the audits conducted, they produce a much greater percent of the assessments.

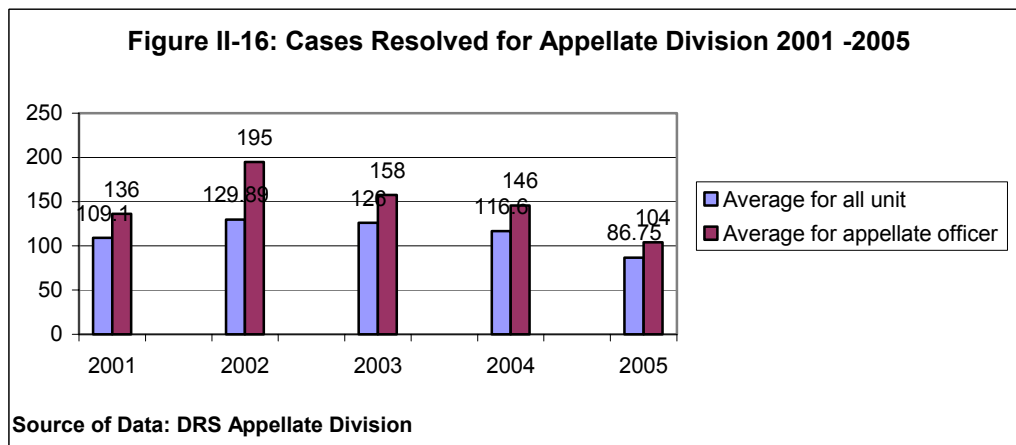
Trends in assessments. It might be expected that overall assessment amounts have declined given that the number of audits has decreased. If examined on a per-audit basis, the amount of assessments has increased each year since FY 03, which indicates better results for each audit, and might suggest better audit targeting.



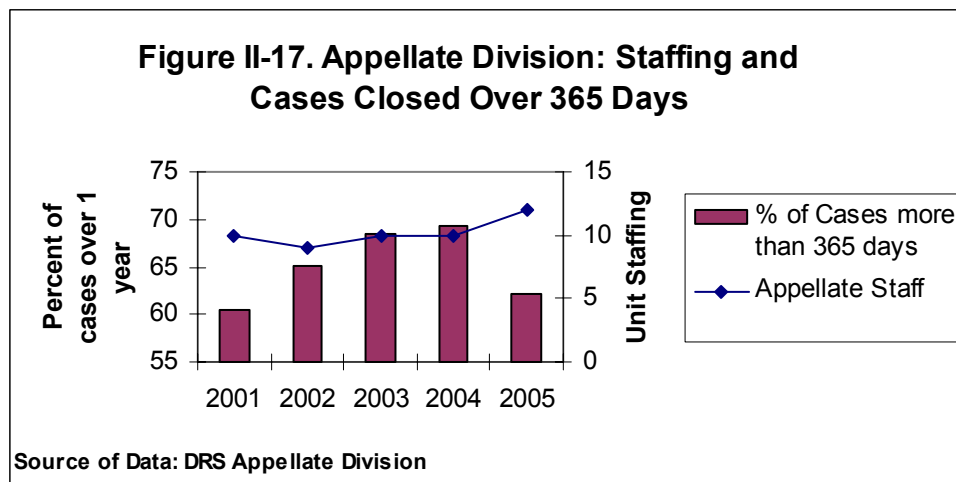
Appellate Division

Audit assessments do not automatically translate into revenue collected. First, many taxpayers appeal the audit results. The ratio of audit assessments appealed is very low, about 1.3 percent. Those appeals are handled by the DRS Appellate Division. The Appellate Division currently has 12 staff – 10 appellate officers, one tax appellate specialist, and a unit manager. However, the unit has not always been fully staffed, nor has there been stability by staffing category. In 2001, the unit had only nine staff; staffing increased after 2001, but from 2002 through 2004, the unit was without a manager.

The unit caseload and caseload per-officer spiked in 2002, when the average number of cases for each officer increased by about 50 percent (almost 200 each) from 2001. Since 2002, cases have leveled off; at 2005 staffing levels, the average caseload for the unit and each appellate officer will be at (or lower) 2001 levels.



Age of appellate cases. During the period between 2001 and 2005, the case backlog grew, thus cases were taking longer to close. This is illustrated in Figure II-17, which shows unit staffing levels measured against the percentage of resolved cases that were more than a year old when closed. As the graph shows, the staffing reduction appears to have had an impact (although a somewhat delayed one) on how long before a case is closed. Using this measure, the percent of cases that were more than a year old at closing, went from about 60 percent to almost 70 percent in 2004, before dropping to slightly more than 62 percent in 2005. Probably more notable than the trend is the fact that over the five-year period, substantially more than half of the cases are more than a year old when closed.



Another negative impact of the delays in the Appellate Division on taxpayers is that can be costly to the appellant. The program review committee heard complaints that delays in closing appeal cases at DRS are costing taxpayers greatly because of the monthly interest charged on the audit assessments. The statute currently sets the interest rate at 1 percent per month (or 12 percent a year) from the date when the original tax was due and payable. The rate appears high compared to the IRS which sets its annual rate at the federal short-term interest rate plus 3 percent, and Massachusetts which is adjusting its interest rates to the Federal short-term interest rate plus 4 percent.

Appellate cases. DRS provided program review with data on the number of “hearings” held by the Appellate Division over the past four years. However, DRS explained its appellate proceedings are informal, and “hearings” can mean a telephone conference call, or any other opportunity for taxpayers to submit additional information or present a case to dispute the audit findings and/or the assessment amount.

Thus, there may be more than one “hearing” on a case, while on the other hand the appellate may review the additional information and make a decision based on that without additional input from the taxpayer. In addition, hearings held in one year may be related to a case from a prior year. Program review requested to observe DRS appeal hearings, but was told these are considered confidential. DRS was also unable to indicate how many of the taxpayers appealing cases had legal representation.

If a taxpayer is not satisfied with the DRS appellate decision in the case, the taxpayer may appeal to the Tax Session of the New Britain Superior Court, the court that handles all appeals of administrative decisions of any state agency, including DRS. The department did provide the number of the cases appealed to court, but did not provide the outcomes of the cases, indicating that all but those decided by a court ruling are considered confidential. Cases that are appealed to court are not considered closed by DRS while under appeal.

Despite these qualifiers, the Appellate Division has more comprehensive data on workload and outcomes than other DRS operational divisions. The information on appellate cases is presented in Table II-3.

Table II-3. DRS Appellate Cases: FY 01—FY 05					
	Cases Received	“Hearings” held	Appealed to Court	% of Cases Appealed	Cases Closed
FY 01	1247	N/A	N/A	-	1091
FY 02	1307	767	48	3.6%	1169
FY 03	1136	924	72	6.3%	1260
FY 04	781	1178	36	4.6%	1166
FY 05	971	1224	41	4.2%	1097
Total	5442	4093	197	4.7%*	5783
Source of Data: DRS Appellate Division (* based on FY 02-FY 05)					

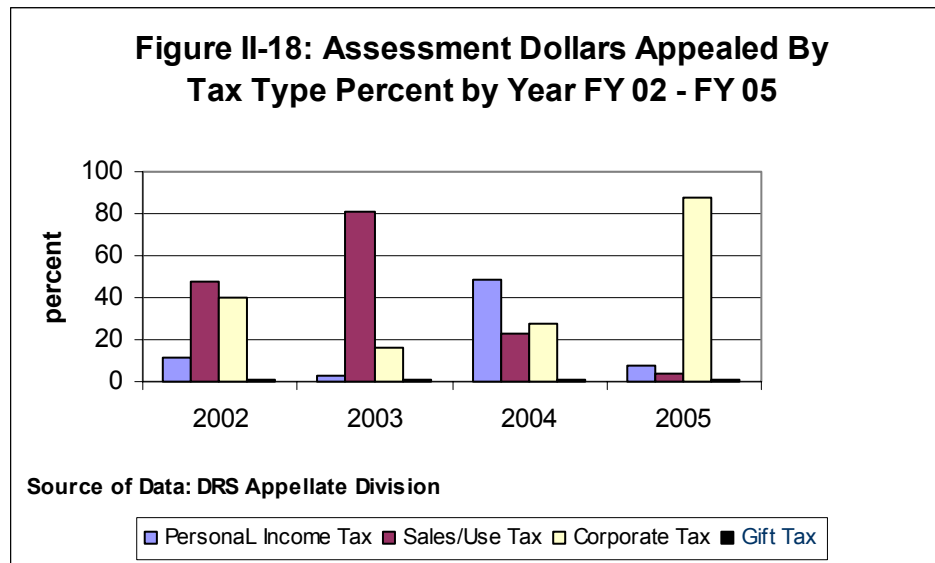
The table shows that there has been a reduction in the number of cases appealed since the high point in FY 02 – a 40 percent reduction in FY 04 and a 26 percent reduction in FY 05. However, the activity level – measured by “hearings” held has increased, which could indicate that the cases were harder to settle, or that with fewer cases received in FY 04 and FY 05, the division was processing the cases that had been received in FY 03 or earlier. Further, over the period, the division closed more cases than it received, again indicating it was reducing previous backlog. The table also indicates that the percentage of DRS cases appealed to court has not changed substantially over the period and, except for FY 03, is under five percent of cases.

The makeup of the appellate cases averaged over the period was:

- 34 percent of the 5442 appellate cases were personal income tax cases;
- 27 percent were sales and use tax;
- 14 percent were corporate income tax; and
- 11 percent involved the gift tax.

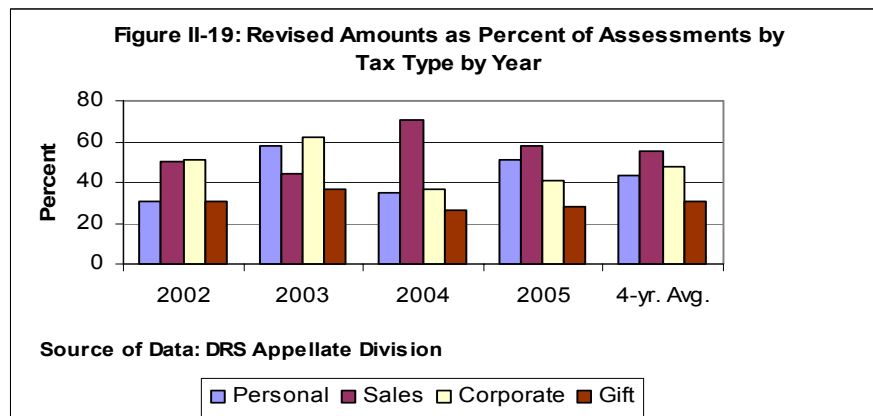
Appellate outcomes. The Appellate Division does not keep statistics on whether cases were closed in favor of the taxpayer or upheld the action of the Audit Division. This is because often cases are not closed in favor of one party or the other, but rather a reduction in the amount assessed at audit. The Appellate Division provided information on what the total assessed amounts under appeal each year and what the revised amounts were after appeal. These overall amounts are presented in Table II-4 below. As the table shows, the amounts assessed are reduced by more than half at the Appellate Division.

Table II-4. Appellate Division Outcomes					
	FY 01	FY 02	FY 03	FY 04	FY 05
Gross Billing \$	\$143,077,112	\$113,118,035	\$236,448,862	\$162,299,731	\$157,534,295
Revised \$ Amount	\$67,076,550	\$55,107,185	\$116,784,208	\$70,120,512	\$62,521,163
% Revision of Total	46%	49%	49%	43%	40%
Source of Data: DRS Appellate Division					



barely measurable. (2004 was the exception when more than 40 percent of the PIT assessment amounts were appealed.)

Corporate income taxes, on the other hand made up less than 14 percent of the appellate cases, but in 2005, the amount of assessments appealed was about 80 percent of the total, and in 2002 about 40 percent. Sales and use tax comprised about 25 percent of the appellate cases, but like corporate accounted for 80 percent in 2003 and almost 50 percent in 2002. Only in the gift



The make up of audit assessment dollars that are appealed shows a somewhat different distribution than appellate cases. For example, while the personal income tax comprised about 36 percent of the cases in three of the four years included in Figure II-18, PIT as a percent of assessment dollars is

barely measurable. (2004 was the exception when more than 40 percent of the PIT assessment amounts were appealed.)

Corporate income taxes, on the other hand made up less than 14 percent of the appellate cases, but in 2005, the amount of assessments appealed was about 80 percent of the total, and in 2002 about 40 percent. Sales and use tax comprised about 25 percent of the appellate cases, but like corporate accounted for 80 percent in 2003 and almost 50 percent in 2002. Only in the gift tax area do percentage of appeal cases and percent of assessment dollars appealed closely match.

The program review committee further analyzed the Appellate Division outcomes to determine if there were differences in the revisions by tax type. The results of the analysis

are presented in Figure II-19. For the four-year average outcomes (the grouping plotted on the right side of the figure), all the revised amounts for each tax, except the sales tax, were less than half the initial amounts under appeal. In other words, the reductions in assessment at appeal are great; typically more than half.

It is difficult for the committee to make a determination on the reasons why the reduction amounts are so significant at appeals without more detailed information about the cases, for example, the major issues surrounding the appeal or whether the taxpayers had legal representation and if that had an impact, and without being able to observe the procedures.

Possible explanations include:

- DRS auditors are zealous in performing the audit function, determining high assessments, recognizing the amounts will likely be reduced through the appeals process;
- contestable statutory, regulatory and policy definitions on issues as complex as nexus and apportionment or as commonplace as interpretations of what is a taxable food item are to be expected; and
- a litigious environment and an attitude among taxpayers that they would rather contest tax liability than pay.

Collections and Enforcement

Once a case has been closed at appellate, the vast majority of cases go to Collection and Enforcement for collection. A small fraction of cases (less than 10 percent as noted above) are appealed to Superior Court. These cases are not considered closed at the Appellate Division until the court disposes of the case in some manner. If the disposition from court requires any collections, that case would also go to DRS Collection and Enforcement.

Activities. The Collections and Enforcement Unit is composed of revenue agents who pursue collections through a variety of means:

- establish written, phone, or direct contact with taxpayers;
- set taxpayers with an unpaid tax liability up on payment schedules;
- place liens; and
- make arrests as a result criminal investigations conducted by certain authorized personnel within the Collection and Enforcement unit.

DRS also contracts with three private collections agencies to collect delinquent accounts. The assignment of the cases and amounts are made by the unit. The Collections and Enforcement Unit provided collections statistics to the committee. One of the actions that can be taken by private collection agencies that DRS does not do is to report delinquent taxes to credit reporting agencies. The committee was unable to determine how frequently this action is taken by the collections agencies, or with what results. Also, the committee could not determine within the timeframe of the study if other state tax agencies have that authority. It does appear to be a less

drastic enforcement step than placing a lien, yet taxpayers might respond to this, knowing how credit scores can impact one's ability to engage in many financial transactions.

The Collections and Enforcement Unit has also experienced staffing reductions. Prior to the layoffs and early retirements, the unit had a staff of 99 filled positions. The staffing estimate for FY 05 is 76 permanent full-time positions, a reduction of 23 percent.

Collections as a percent of accounts receivable were provided by DRS for FY 02 and FY 03; those rates were 67 percent and 51 percent, respectively. However, DRS could not calculate the rates for FY 04 or FY 05, again due to changes the way data are being collected with ITAS implementation. The committee was also unable to trend or analyze enforcement activity or workload measures over time, because much of the activity data reported under the division's former automated system are no longer available under ITAS.

AUTOMATED SYSTEMS

Automated information systems that incorporate up-to-date, high quality software and hardware and integrate all major functions are critical for successful tax administration. DRS has been working to replace and upgrade all of its existing computer systems, some of which are more than 35 years old, since 1994. The goal is to have one database and a single system for all common administrative functions for all state taxes. Implementation of the agency's new Integrated Tax Administration System will permit more efficient operations, increased compliance, improved customer service, and better information for management decisions.

The project has experienced delays and cost overruns, but system implementation, which is occurring in four major phases, is actively underway at this time. The total final cost is estimated to reach \$70 million and ITAS is now expected to be fully in place by September 2006. The current status of each major phase of ITAS is summarized in Appendix J.

At present, integrated taxpayer registration, return processing, and accounting functions for all business taxes are up and running. Development of similar functions for the personal income tax is in progress, and they are expected to be fully operational by July 2006; PIT revenue accounting is already functioning. The last two phases, which primarily involve automating a variety of internal management and customer service functions, are scheduled to be completed by September 2006.

Upon completion of all four phases, DRS anticipates all tax administration functions will be operated through the ITAS system, management functions will be integrated and automated department wide, and the agency's former computer systems will be retired. Agency staff is expected to have greater user control over data entry and retrieval and be less reliant on technical support to both access and report information. On-line customer service functions such as registration, address changes, refund inquiries, and help menus will be available to all taxpayers.

A significant system deficiency, however, is that ITAS produces very few management reports and has little ability to track administrative activities. What management information the new system will be able to provide and whether it will be comparable to previous revenue and work activity report data is not clear at this time.

The main measures of overall agency performance monitored by the commissioner described earlier in this section, for example, cannot be produced by ITAS at present. Information on agency enforcement actions (e.g., warrants issued, liens place, arrests made) that were reported by a former system within the collections unit, are unavailable through ITAS for all taxes at this time. Most of the productivity statistics the collections manager formerly tracked (e.g., dollars collected, percent of receivables assigned to collection and enforcement, inventory “turnover” in terms of cases and dollar value, and average age of cases) are not reported by ITAS and may not be for some time.

As the result of a data request from the program review committee, DRS management also recently became aware of problems related to the agency’s collection rate statistics (e.g., the amount of the accounts receivable inventory sent to the collections unit that is collected and deposited each year). According to the agency’s ITAS consultant, collection rates cannot be produced for Fiscal Years 04 or 05 due to the phase-in process used to convert data to ITAS; a method for calculating comparable rates in the future is expected to be developed in a few months.

Further, it has not been determined how ITAS, specifically its data warehouse component, will capture certain information that is currently provided on income tax returns but not compiled, such as the amount of local property taxes paid or the total income earned by pass through entities. These data would be helpful to the department in targeting auditing efforts and to policymakers interested in researching the distribution of tax liability by income group.

The fact that ITAS is, as DRS managers have told the committee, “management report poor” and unable to produce many previously available basic statistics on agency operations seems evidence of a low priority given to performance measurement by the agency as well as insufficient planning for the conversion process. According to top managers, reporting improvements are planned but will not be taken up until after the system is in place and running for a time, perhaps within two years. At that point, an assessment of information needs of the operational units and top management will be made and a strategic plan will be developed, most likely with the help of the Office of Planning and Organizational Development.

SELECTED MANAGEMENT PRACTICES

In carrying out this aspect of the study, the program review committee observed both strengths and weaknesses in some of the department’s overall management practices that have an impact on administrative efficiency and effectiveness. The committee’s findings concerning several key agency management functions are highlighted below.

Internal controls. Preserving the confidentiality of taxpayer information is a top priority of the Department of Revenue Services. Internal security controls seem strong; an internal audit unit was created two years ago with a primary function of protecting the state and federal taxpayer data held by the agency. The department expects to expand the unit’s scope of activities and staffing to all internal control processes as well as selected transactional areas that could have security risks.

Like a number of states, Connecticut has a statutory taxpayer “bill of rights” (C.G.S. Section 12-39n). According to DRS policy, it “... guarantees that the rights, privacy, and property of Connecticut taxpayers are safeguarded and protected during tax assessment, collection, and enforcement processes administered under the revenue laws of this state.” Information about taxpayer rights is available on the DRS website although it is not prominently displayed; a link to the policy is provided under business taxpayers information at present.

DRS strictly interprets its obligations to maintain taxpayer privacy and ensure confidentiality of its tax records. It exercises firm control over access to data in compliance with state laws intended to promote public confidence that information submitted by taxpayers will be kept confidential. It also implements IRS standards, “Tax Information Security Guidelines of Federal, State, and Local Agencies,” for safeguarding federal tax information.

However, the department’s interpretation of “confidential information” seems extreme. For example, the committee could not obtain all the aggregate non-identifying taxpayer data it sought. The statute that governs DRS’ disclosure of “return information” (defined as a taxpayer’s identity, the nature, source or amount of the taxpayer’s income, etc.) is understandably restrictive (C.G.S. Sec. 12-15). However, the statute also defines what “return information” does not include: “...data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.” Despite that provision, DRS would not provide, for example, the median tax paid for specific tax types as it would come from individual tax information. Further, DRS stated appellate proceedings are confidential and denied the committee’s request to observe, and similarly, any description of outcomes from appellate activities (except for court decisions) were described as confidential. These access issues hampered the committee’s ability to assess overall tax policy and tax administration.

The department requires all of its permanent and temporary employees to sign a confidentiality agreement about the disclosure of tax information; it only shares its data with other state agencies in accordance with formal written agreements for ensuring confidentiality. In addition, DRS indicates it performs background checks on all potential agency employees before being hired. However, similar checks are not conducted on all employees of agency contractors and vendors, although they are required to sign confidentiality agreements. DRS further indicated access to confidential taxpayer information by contractor personnel is limited.

It appears from statistics provided by the internal audit division that there have been few confidentiality breaches and when violations are found to occur, disciplinary actions are taken. The division has been responsible for investigating potential ethics code (including confidentiality) violations since it was formed in January 2004. Since that time to December 2005, the division has handled a total of 25 potential violations, 23 of which involved DRS employees and two of which involved employees of other agencies (and were therefore forwarded to the head of that agency for investigation and any disciplinary action). Regarding the DRS cases: in 11, no action was taken because the division found no violation; in one, no action was taken because the temporary employee involved was no longer with the agency; and in 11, a violation was found. In these cases, the following actions were taken: one termination; nine suspensions (from one to five days); and one reprimand.

Research. The department has limited capacity for research and planning activities. At present, there are only three positions assigned to the agency research office and those staff also have responsibility for legislative affairs. The primary role of the research office is to provide statistical information on state taxes as required by statute and requested by OFA and OPM for forecasting and policy analysis purposes. The office does not conduct tax policy research; according to the commissioner, that function within the executive branch is appropriate for the Office of Policy and Management, not DRS whose mission is to "... administer the tax laws of the State of Connecticut and collect the tax revenues in the most cost effective manner."

Recently, the demands of ITAS implementation on the research staff has meant the office has had little time for many of its regular duties. It has been unable to produce the agency's annual tax report, a primary way DRS meets its public accountability obligations, since FY 03.

Strategic planning. The strategic business plan that led to the development of ITAS is the last comprehensive document prepared to guide the department's activities. Before the most recent series of employee layoffs, the department had a small planning office but currently there is no centralized responsibility for strategic planning. Therefore, DRS has not maintained an up-to-date strategic plan. That function may be included in the scope of OPOD duties in the future.

Strategic planning is more than just long-term planning. The Office of Policy and Management defines strategic planning as "a process of organizational self assessment, goal setting, strategy development, and performance monitoring."²⁵ Strategic planning helps to shape and guide what an organization is, what it does, and why it does it. It has been long recognized as an important part of successful, results-oriented management. Among other things, the strategic planning process, when conducted properly, not only identifies agency objectives but assists in ascertaining an agency's strengths and weaknesses and determines if its internal capabilities are adequate to accomplish its mission and goals.

Performance measurement. DRS collects a variety of data about its major activities, reports on a number of program indicators in its budget documents, and has developed performance measures for some areas of the agency. For example, the information collected and standards developed for the taxpayer services division's call center activities represents a well developed performance measurement system.

Most of the activity data DRS prepares and provides in its public documents, however, are measures of inputs and outputs rather than outcomes. The information included in the department's budget, which the program review committee found necessary to rely on in completing this section of the study, covers a narrow scope of agency activities and is only produced for the initial year of the biennium. In general, little workload (e.g., cases per staff person), timeliness (days to process), or functional cost information was available from the department; in most cases, basic outcome measures such as error/accuracy rates, rates of compliance by type of tax or taxpayer could not be provided to the committee within the timeframe of study. As discussed earlier in this section, a number of activity measures tracked with prior automated systems are not produced by ITAS.

²⁵ OPM, State of CT, *Strategic Business Planning: A Guide for Executive Branch Agencies*, Sept. 1998, p.1.
Program Review and Investigations Committee Findings and Recommendations: Adopted January 19, 2006

Performance measurement is closely related to strategic planning. The development of a performance measurement system helps in understanding the links between the department's performance and successful accomplishment of its strategic objectives. In a revenue-constrained environment, public agencies should continually assess whether what they are doing can be accomplished in a better, more cost-effective manner.

Enhanced and more complete management information would, for example, allow DRS to understand the reasons for variation in performance over time and across the agency. For example, better data on inputs and outcomes could explain why, as noted in the above program review analysis, some parts of the department appear to have maintained productivity levels despite staff reductions, while others have not. It could also be used to examine specific aspects of performance such as why it takes over a year to resolve most tax appeals and what contributes to assessment reduction rates of 50 percent, on average, at the Appellate Division.

Ultimately, sufficient, credible, and timely information about how the department is administered will assist managers and policymakers ensure the department is being effectively and efficiently administered and is providing fair, high quality services. By the end of this year, ITAS will be the agency's only automated information system. The extent to which ITAS can provide good quality management information, including appropriate performance measures, is unknown at this time.

APPENDICES

Appendix A. Fiscal Year 05 and 06 Major State Grants to Municipalities							
Program	Statutory Reimbursement Rate	Fiscal Year 05			Fiscal Year 06		
		Amount Required by Statutory Formula (millions)	Estimated Expenditure (millions)	Actual Percent of Statutory Amount Reimbursed	Amount Required by Statutory Formula (millions)	Appropriation (millions)	Estimated Percent Reimbursement Rate
State Owned Property	100% for correctional facilities; 100% for towns with more than 50% of all property is state owned; 65% for Connecticut Valley Hospital; 145% for all other property	\$ 93.10	\$ 72.50	77.9%	\$ 100.20	\$ 78.00	77.8%
Private Colleges and Free Standing Chronic Disease Hospitals	77% of tax losses due to real property exemptions for eligible private colleges and general and free standing chronic disease hospitals	134.80	105.90	78.6%	141.00	111.20	78.9%
Electric Generation Facilities	100% 1 st year and 10% less each year	11.30	11.30	100.0%	9.30	9.30	100.0%
Distressed Municipalities	50% of revenue loss due to certain exemptions granted to qualified businesses	7.80	7.80	100.0%	7.80	7.80	100.0%
Manufacturing Machinery and Equipment and Commercial Vehicles	100% to 80% of revenue loss as a result of state mandated exemptions	59.70	50.70	84.9%	55.30	55.30	100.0%
Vessels	Each municipality receives an amount equal to property tax receipts for boats on its 1978 Grand List	2.30	2.30	100.0%	2.30	2.30	100.0%
Elderly/Disabled Freeze Program (Closed in 1978 to new applicants)	100% of revenue loss due to program	1.90	1.90	100.0%	1.40	1.40	100.0%
Elderly/ Disabled Circuit Breaker Program	100% of revenue loss due to program	20.50	20.50	100.0%	20.50	20.50	100.0%

Appendix A. Fiscal Year 05 and 06 Major State Grants to Municipalities							
Program	Statutory Reimbursement Rate	Fiscal Year 05			Fiscal Year 06		
		Amount Required by Statutory Formula (millions)	Estimated Expenditure (millions)	Actual Percent of Statutory Amount Reimbursed	Amount Required by Statutory Formula (millions)	Appropriation (millions)	Estimated Percent Reimbursement Rate
Disabled Tax Relief Program	100% of revenue due to program	0.25	0.25	100.0%	0.53	0.53	100.0%
Veteran's Additional Exemption	100% of revenue loss due to program	2.90	2.90	100.0%	2.90	2.90	100.0%
<i>Sub-total PILOT</i>		<i>\$ 334.55</i>	<i>\$ 276.05</i>	<i>82.5%</i>	<i>\$ 341.23</i>	<i>\$ 289.23</i>	<i>84.8%</i>
Other Grant Programs							
Mashantucket Pequot /Mohegan Fund	Grant calculations depend on various statutory formulas	\$ 135.00	\$ 85.00	63.0%	\$ 135.00	\$ 86.20	63.9%
Education*	Various	1,984.66	1,890.76	95.0%	2,086.29	2,010.29	96.4%
Other (estimated)	Various	49.92	49.92	100.0%	57.89	57.89	100.0%
<i>Sub-total Other Grants</i>		<i>\$2,169.58</i>	<i>\$ 2,025.68</i>	<i>93.4%</i>	<i>\$2,279.17</i>	<i>\$ 2,154.37</i>	<i>94.5%</i>
GRAND TOTAL		\$2,504.13	\$ 2,301.73	91.9%	\$2,620.90	\$ 2,443.60	93.3%
* Only includes full funding of ECS, not other categorical grants that have been capped Source: OPM							

Appendix B. Tax Rate Changes After Revaluation (2002-2004): Actual Rate vs. Level Spending Rate

TOWN	YEAR OF REVAL	ASSESSED VALUE IN YEAR PRIOR TO REVAL ASSESSMENT	ASSESSED VALUE IN YEAR OF REVAL ASSESSMENT	% GROWTH IN ASSESSED VALUE	TAX RATE PRIOR TO REVAL	TAX LEVY	LEVEL SPENDING TAX RATE (based on same levy)	ACTUAL TAX RATE AFTER REVAL	DIFFERENCE BETWEEN ACTUAL AND LEVEL RATE
Ansonia	2002	\$609,944,866	\$779,016,240	27.72%	36.30	\$22,140,999	28.42	29.40	3%
Ashford	2002	\$174,721,540	\$212,592,790	21.68%	34.50	\$6,027,893	28.35	29.00	2%
Avon	2003	\$1,665,355,100	\$2,068,527,315	24.21%	28.30	\$47,129,549	22.78	23.46	3%
Barkhamsted	2003	\$218,136,820	\$282,290,952	29.41%	32.20	\$7,024,006	24.88	26.10	5%
Berlin	2002	\$1,246,928,870	\$1,576,552,185	26.43%	31.40	\$39,153,567	24.83	25.30	2%
Bethany	2003	\$356,108,316	\$493,175,055	38.49%	32.93	\$11,726,647	23.78	25.66	8%
Bethel	2002	\$1,144,653,733	\$1,538,269,760	34.39%	31.44	\$35,987,913	23.40	24.55	5%
Bethlehem	2003	\$237,581,297	\$340,835,311	43.46%	28.71	\$6,820,959	20.01	19.10	-5%
Bloomfield	2004	\$1,140,850,451	\$1,657,388,341	45.28%	42.33	\$48,292,200	29.14	31.03	6%
Bolton	2003	\$274,403,920	\$374,675,710	36.54%	36.20	\$9,933,422	26.51	27.91	5%
Bozrah	2002	\$130,894,627	\$167,443,400	27.92%	24.00	\$3,141,471	18.76	20.50	9%
Branford	2002	\$2,038,883,517	\$2,722,638,500	33.54%	29.14	\$59,413,066	21.82	22.79	4%
Branford	2004	\$2,723,431,438	\$3,240,869,323	19.00%	23.94	\$65,198,949	20.12	20.97	4%
Bridgeport	2003	\$3,408,424,832	\$5,156,345,541	51.28%	55.20	\$188,145,051	36.49	38.99	7%
Bridgewater	2003	\$205,355,936	\$313,023,413	52.43%	26.00	\$5,339,254	17.06	17.50	3%
Bristol	2002	\$2,392,009,590	\$2,846,069,850	18.98%	32.25	\$77,142,309	27.10	30.93	14%
Brooklyn	2004	\$320,955,966	\$460,348,893	43.43%	27.34	\$8,774,936	19.06	19.90	4%
Burlington	2003	\$535,885,691	\$706,861,469	31.91%	31.50	\$16,880,399	23.88	25.50	7%
Canaan	2002	\$88,791,191	\$115,490,540	30.07%	31.25	\$2,774,725	24.03	26.50	10%
Canterbury	2004	215,575,751	\$325,397,091	50.94%	30.50	\$6,575,060	20.21	20.50	1%
Canton	2003	\$581,610,340	\$760,654,259	30.78%	34.02	\$19,786,384	26.01	27.66	6%
Chaplin	2003	\$86,597,060	\$119,231,580	37.69%	42.00	\$3,637,077	30.50	31.00	2%
Cheshire	2003	\$1,831,353,830	\$2,414,590,310	31.85%	33.70	\$61,716,624	25.56	25.75	1%
Chester	2003	\$290,360,432	\$399,730,828	37.67%	27.53	\$7,993,623	20.00	21.90	10%
Coventry	2004	\$603,867,285	\$804,282,550	33.19%	31.86	\$19,239,212	23.92	25.92	8%
Cromwell	2002	\$748,586,252	\$950,447,183	26.97%	30.84	\$23,086,400	24.29	26.30	8%
Danbury	2002	\$4,562,023,370	\$5,871,260,940	28.70%	25.24	\$115,145,470	19.61	24.29	24%
Darien	2003	\$4,252,685,985	\$6,222,450,581	46.32%	16.00	\$68,042,976	10.94	11.95	9%
East Granby	2003	\$365,307,293	\$459,899,869	25.89%	31.40	\$11,470,649	24.94	25.20	1%

Appendix B. Tax Rate Changes After Revaluation (2002-2004): Actual Rate vs. Level Spending Rate

TOWN	YEAR OF REVAL	ASSESSED VALUE IN YEAR PRIOR TO REVAL ASSESSMENT	ASSESSED VALUE IN YEAR OF REVAL ASSESSMENT	% GROWTH IN ASSESSED VALUE	TAX RATE PRIOR TO REVAL	TAX LEVY	LEVEL SPENDING TAX RATE (based on same levy)	ACTUAL TAX RATE AFTER REVAL	DIFFERENCE BETWEEN ACTUAL AND LEVEL RATE
East Haddam	2002	\$469,062,872	\$635,436,107	35.47%	30.90	\$14,494,043	22.81	24.41	7%
East Windsor	2002	\$560,834,835	\$691,763,081	23.35%	29.58	\$16,589,494	23.98	24.70	3%
Eastford	2002	\$69,138,536	\$90,807,663	31.34%	35.90	\$2,482,073	27.33	28.30	4%
Easton	2002	\$777,448,040	\$1,204,116,720	54.88%	30.50	\$23,712,165	19.69	21.65	10%
Essex	2003	\$667,426,594	\$987,188,228	47.91%	20.00	\$13,348,532	13.52	14.90	10%
Farmington	2002	\$2,047,929,340	\$2,614,719,375	27.68%	26.50	\$54,270,128	20.76	21.90	6%
Franklin	2003	\$121,767,716	\$161,066,433	32.27%	26.30	\$3,202,491	19.88	20.63	4%
Glastonbury	2002	\$2,140,435,400	\$2,894,616,450	35.23%	36.70	\$78,553,979	27.14	28.75	6%
Goshen	2002	\$235,325,765	\$347,650,733	47.73%	24.50	\$5,765,481	16.58	20.00	21%
Granby	2002	\$583,589,640	\$761,567,540	30.50%	37.06	\$21,627,832	28.40	30.60	8%
Guilford	2002	\$1,498,123,896	\$2,422,011,365	61.67%	32.47	\$48,644,083	20.08	21.17	5%
Hampton	2003	\$81,934,822	\$115,399,164	40.84%	39.70	\$3,252,812	28.19	28.25	0%
Hartland	2002	\$120,106,000	\$143,955,010	19.86%	27.25	\$3,272,889	22.74	24.00	6%
Harwinton	2003	\$329,760,902	\$440,491,912	33.58%	31.90	\$10,519,373	23.88	24.2	1%
Kent	2003	\$318,433,304	\$446,447,826	40.20%	21.00	\$6,687,099	14.98	15.83	6%
Killingly	2002	\$600,541,272	\$749,110,175	24.74%	22.90	\$13,752,395	18.36	21.40	17%
Lebanon	2003	\$339,152,481	\$453,107,002	33.60%	27.40	\$9,292,778	20.51	23.30	14%
Litchfield	2003	\$639,354,526	\$834,707,126	30.55%	27.37	\$17,499,133	20.96	21.40	2%
Lyme	2003	\$282,376,765	\$491,801,071	74.16%	19.00	\$5,365,159	10.91	12.40	14%
Madison	2002	\$1,493,448,440	\$2,366,043,283	58.43%	27.71	\$41,383,456	17.49	19.11	9%
Mansfield	2004	\$575,989,725	\$865,549,574	50.27%	30.63	\$17,642,565	20.38	22.01	8%
Middletown	2002	\$2,058,166,070	\$2,540,320,710	23.43%	31.20	\$64,214,781	25.28	27.30	8%
Monroe	2003	\$1,433,022,598	\$2,008,684,515	40.17%	30.58	\$43,821,831	21.82	22.88	5%
Morris	2004	\$226,148,631	\$327,024,606	44.61%	27.46	\$6,210,041	18.99	19.90	5%
Naugatuck	2002	\$1,163,197,160	\$1,360,378,140	16.95%	35.50	\$41,293,499	30.35	33.00	9%
New Britain	2002	\$1,518,115,151	\$2,072,027,757	36.49%	54.76	\$83,131,986	40.12	46.93	17%
New Canaan	2003	\$5,543,867,740	\$6,560,018,770	18.33%	13.99	\$77,558,710	11.82	12.66	7%
New Fairfield	2004	\$1,139,968,100	\$1,805,374,885	58.37%	28.75	\$32,774,083	18.15	19.07	5%
New Hartford	2003	\$408,651,064	\$539,116,504	31.93%	32.40	\$13,240,294	24.56	26.10	6%

Appendix B. Tax Rate Changes After Revaluation (2002-2004): Actual Rate vs. Level Spending Rate

TOWN	YEAR OF REVAL	ASSESSED VALUE IN YEAR PRIOR TO REVAL ASSESSMENT	ASSESSED VALUE IN YEAR OF REVAL ASSESSMENT	% GROWTH IN ASSESSED VALUE	TAX RATE PRIOR TO REVAL	TAX LEVY	LEVEL SPENDING TAX RATE (based on same levy)	ACTUAL TAX RATE AFTER REVAL	DIFFERENCE BETWEEN ACTUAL AND LEVEL RATE
New London	2003	\$853,428,402	\$1,257,260,090	47.32%	35.40	\$30,211,365	24.03	25.34	5%
Newtown	2002	\$1,834,210,903	\$2,795,791,878	52.42%	33.80	\$61,996,329	22.17	23.40	6%
Norfolk	2003	\$165,446,287	\$199,651,892	20.67%	28.26	\$4,675,512	23.42	24.82	6%
North Canaan	2002	\$202,629,480	\$237,368,280	17.14%	24.80	\$5,025,211	21.17	22.80	8%
Norwalk	2003	\$6,521,758,664	\$10,040,939,406	53.96%	28.97	\$188,935,348	18.82	26.41	40%
Norwich	2003	\$1,166,095,643	\$1,745,510,827	49.69%	36.77	\$42,877,337	24.56	25.69	5%
Old Lyme	2004	\$908,273,130	\$1,470,628,390	61.91%	25.50	\$23,160,965	15.75	16.60	5%
Old Saybrook	2003	\$1,109,642,467	\$1,853,824,563	67.07%	21.57	\$23,934,988	12.91	13.80	7%
Plainfield	2002	\$499,672,829	\$627,415,393	25.57%	27.40	\$13,691,036	21.82	22.70	4%
Pomfret	2004	\$216,020,072	\$324,646,550	50.29%	26.24	\$5,668,367	17.46	18.22	4%
Preston	2002	\$213,096,731	\$262,885,656	23.36%	24.00	\$5,114,322	19.45	21.85	12%
Putnam	2003	\$339,056,462	\$463,862,230	36.81%	17.25	\$5,848,724	12.61	14.35	14%
Redding	2002	\$994,598,609	\$1,397,759,855	40.54%	29.00	\$28,843,360	20.64	21.25	3%
Ridgefield	2002	\$2,715,899,539	\$4,010,804,099	47.68%	27.58	\$74,904,509	18.68	20.77	11%
Rocky Hill	2003	\$1,233,515,550	\$1,542,838,700	25.08%	29.30	\$36,142,006	23.43	25.80	10%
Roxbury	2002	\$303,437,720	\$469,709,305	54.80%	20.20	\$6,129,442	13.05	15.40	18%
Scotland	2003	\$70,586,377	\$89,308,157	26.52%	36.10	\$2,548,168	28.53	31.47	10%
Sharon	2003	\$391,410,792	\$518,775,238	32.54%	17.00	\$6,653,983	12.83	13.75	7%
Sherman	2003	\$406,011,080	\$633,164,196	55.95%	21.00	\$8,526,233	13.47	14.00	4%
Simsbury	2002	\$1,509,361,938	\$1,929,367,631	27.83%	39.10	\$59,016,052	30.59	32.60	7%
Somers	2004	\$485,595,523	\$728,720,714	50.07%	28.56	\$13,868,608	19.03	20.25	6%
South Windsor	2002	\$1,436,998,902	\$1,936,669,777	34.77%	37.55	\$53,959,309	27.86	29.79	7%
Southbury	2002	\$1,502,395,442	\$1,951,940,804	29.92%	24.60	\$36,958,928	18.93	21.00	11%
Sprague	2004	\$117,191,211	\$192,996,426	64.69%	30.50	\$3,574,332	18.52	23.50	27%
Sterling	2002	\$126,584,521	\$153,683,206	21.41%	27.50	\$3,481,074	22.65	24.25	7%
Stonington	2002	\$1,259,670,730	\$1,983,800,207	57.49%	27.46	\$34,590,558	17.44	18.40	6%
Stratford	2004	\$3,166,375,505	\$4,489,705,918	41.79%	36.99	\$117,124,230	26.09	36.37	39%
Suffield	2003	\$771,945,704	\$1,018,776,683	31.98%	29.99	\$23,150,652	22.72	23.61	4%
Thompson	2004	\$385,639,167	\$629,310,971	63.19%	24.63	\$9,498,293	15.09	15.91	5%

Appendix B. Tax Rate Changes After Revaluation (2002-2004): Actual Rate vs. Level Spending Rate

TOWN	YEAR OF REVAL	ASSESSED VALUE IN YEAR PRIOR TO REVAL ASSESSMENT	ASSESSED VALUE IN YEAR OF REVAL ASSESSMENT	% GROWTH IN ASSESSED VALUE	TAX RATE PRIOR TO REVAL	TAX LEVY	LEVEL SPENDING TAX RATE (based on same levy)	ACTUAL TAX RATE AFTER REVAL	DIFFERENCE BETWEEN ACTUAL AND LEVEL RATE
Tolland	2004	\$826,701,388	\$1,143,189,688	38.28%	35.40	\$29,265,229	25.60	27.22	6%
Torrington	2003	\$1,469,470,368	\$1,824,809,737	24.18%	38.28	\$56,251,326	30.83	32.28	5%
Union	2003	\$48,935,354	\$63,580,519	29.93%	27.74	\$1,357,467	21.35	22.66	6%
Warren	2002	\$125,813,119	\$187,365,757	48.92%	23.00	\$2,893,702	15.44	17.72	15%
Washington	2003	\$620,740,760	\$915,387,180	47.47%	16.00	\$9,931,852	10.85	11.00	1%
Waterbury	2002	\$3,267,706,362	\$3,383,320,528	3.54%	54.86	\$179,266,371	52.99	53.31	1%
Waterford	2002	\$1,923,356,520	\$2,497,963,250	29.88%	18.46	\$35,505,161	14.21	16.98	19%
Watertown	2003	\$1,211,043,710	\$1,562,270,164	29.00%	25.91	\$31,378,143	20.08	20.37	1%
Weston	2003	\$1,779,821,750	\$2,361,590,016	32.69%	25.00	\$44,495,544	18.84	20.25	7%
Wethersfield	2003	\$1,459,967,040	\$1,962,287,820	34.41%	34.86	\$50,894,451	25.94	28.35	9%
Willington	2003	\$295,322,996	\$371,825,690	25.90%	28.80	\$8,505,302	22.87	24.77	8%
Wilton	2002	\$2,179,622,760	\$3,602,476,200	65.28%	29.94	\$65,257,905	18.11	20.10	11%
Winchester	2002	\$443,175,289	\$569,484,675	28.50%	35.58	\$15,768,177	27.69	30.12	9%
Windsor	2003	\$1,836,550,760	\$2,256,457,170	22.86%	33.57	\$61,653,009	27.32	28.63	5%
Windsor Locks	2003	\$876,573,597	\$1,114,426,797	27.13%	24.00	\$21,037,766	18.88	20.69	10%
Woodbridge	2004	\$890,206,260	\$1,177,158,808	32.23%	35.58	\$31,673,539	26.91	28.22	5%
Woodbury	2003	\$714,895,717	\$972,895,463	36.09%	27.25	\$19,480,908	20.02	21.42	7%
TOTAL/AVERAGE		\$110,771,055,814	\$151,234,468,008	36.53%	30.39	\$3,366,069,066	22.26	23.75	7%
Source: OPM and LPR&IC calculations									

Appendix C: Options for Redistributing Sales Tax to Municipalities

Municipality	Option C: Redistribution of the Sales Tax		
	#1 Distressed Municipalities	#2 Top 10	#3 Top 10 (minus auto sales)
Berlin	n/a	\$8,536,083.33	\$8,088,806.57
Bridgeport	\$10,289,616.67	\$10,289,616.67	\$9,310,420.59
Danbury	n/a	\$18,256,933.33	\$17,991,007.30
East Hartford	\$7,054,183.33	n/a	n/a
Greenwich	n/a	\$11,340,266.67	\$11,080,808.87
Hartford	\$22,960,233.33	\$22,960,233.33	\$20,384,014.75
Manchester	n/a	\$14,111,483.33	\$12,358,118.27
Meriden	\$4,484,933.33	n/a	n/a
New Britain	\$4,805,816.67	n/a	n/a
New Haven	\$23,121,916.67	\$23,121,916.67	\$21,648,473.09
New London	\$3,819,066.67	n/a	n/a
North Haven	n/a	\$12,554,733.33	\$12,372,140.40
Norwalk	n/a	\$14,614,300.00	\$13,813,308.39
Stamford	n/a	\$18,917,650.00	\$17,533,832.63
Waterbury	\$7,715,816.67	n/a	n/a
West Haven	\$3,601,583.33	n/a	n/a
Winchester	\$533,266.67	n/a	n/a
Total	\$88,386,433.33	\$154,703,216.67	\$144,580,930.85

#4 Planning Region	1% of 2002 Sales Tax Collections
Capitol Region	\$93,038,183.33
Central CT	\$23,731,700.00
Council of Government of the Central Naugatuck Valley	\$18,225,483.33
CT River Estuary	\$5,822,883.33
Greater Bridgeport	\$26,760,383.33
Housatonic	\$29,127,713.89
Litchfield	\$6,078,883.33
Midstate	\$7,761,533.33
Northeastern CT	\$4,031,716.16
Northwestern CT	\$2,223,316.67
South Central CT	\$75,199,100.00
Southeastern CT	\$24,915,916.67
South Western	\$59,869,016.67
Valley	\$12,882,333.33
Windham	\$3,056,583.33
Unidentified (Stafford)	\$1,551,766.67
Total	\$394,276,513.89

Appendix D. Supporting Data Regarding Reliable Principle

Table D-1. State Revenue Volatility: Northeast States and U.S. Average, 1992-2004		
	Average Annual Growth	Standard Deviation
Actual State Revenues		
Connecticut	4.7%	5.8
Maine	4.8%	4.9
Massachusetts	4.6%	6.2
New Hampshire*	7.3%	17.9
New Jersey	4.3%	4.1
New York	3.6%	4.1
Rhode Island	5.3%	4.4
Vermont*	7.8%	12.5
<i>U.S. Average</i>	<i>5.0%</i>	<i>3.4</i>
<i>Conn. Adjusted Revenues</i>	<i>4.9%</i>	<i>4.1</i>
<i>Conn. Personal Income</i>	<i>4.7%</i>	<i>2.6</i>
<i>U.S. Personal Income</i>	<i>5.2%</i>	<i>1.7</i>
Source of Data: U.S. Census		
* Much of the extreme volatility shown for these two states is related to major changes made in each state's tax structure in response to education funding litigation (New Hampshire in 2000 and Vermont in 1999).		

Table D-2. State Revenue and Expenditure Estimates: FY 06 – FY 10 (dollars in thousands)					
	Estimated FY 06	Enacted FY 07	Projected		
			FY 08	FY 09	FY 10
Expenditures					
General Fund	\$ 14,152.5	\$ 14,745.2	\$ 15,884.3	\$ 16,440.8	\$ 17,119.8
All Approp. Funds	\$ 15,307.4	\$ 15,938.7	\$ 17,167.9	\$ 17,752.1	\$ 18,462.4
Appropriations Allowed Under Cap	\$ 15,307.4	\$ 15,974.2	\$ 16,757.7	\$ 17,451.5	\$ 18,306.8
Difference Between All Expenditures and Allowed Approp.	-	\$ (35.5)	\$ 410.2	\$ 300.6	\$ 155.6
Projected Revenue	\$15,616.9	\$ 16,168.3	\$ 16,549.1	\$ 17,054.2	\$17,600.5
Revenue Less All Expenditures	\$ 309.5	\$ 229.6	\$ (618.8)	\$ (697.9)	\$ (861.9)
Revenue less Allowed Approp.	\$ 309.5	\$ 229.6	\$ (208.6)	\$ (397.3)	\$ (706.3)
Source of Data: OPM Fiscal Accountability Report, Nov. 15, 2005					

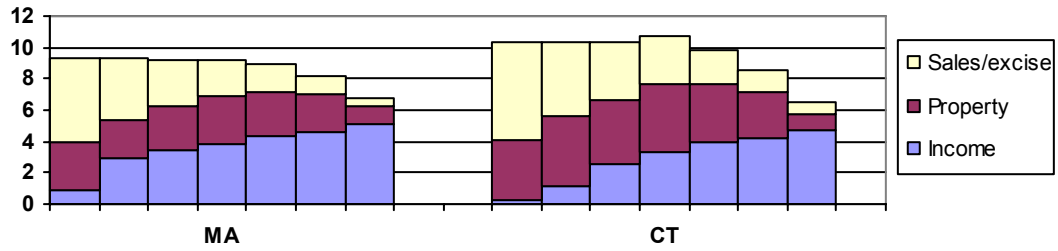
Table D-3. Trends in General Fund Spending: Major Accounts: FY 00 – FY 05

	FY 00 Expenditures (Actual)	FY 05 Expenditures (Estimated)	Pct. Of Total FY 05 GF Expenditures	Avg. Annual Pct. Change FY 00 – FY 05	Cumulative Pct. Change FY 00 – FY 05
Top 10 Major Accounts					
Medicaid	\$ 2,216,789,087	\$ 2,935,009,160	21.8%	5.8%	28.9%
Personal Services	\$ 1,657,435,900	\$ 2,001,914,416	14.9%	3.9%	19.7%
ECS Grant	\$ 1,347,876,789	\$ 1,562,870,000	11.6%	3.0%	15.1%
Debt Service	\$ 926,365,462	\$ 1,311,153,785	9.7%	7.4%	37.0%
Other Expenses	\$ 374,746,949	\$ 461,234,262	3.4%	4.3%	21.6%
Retired State Employee Health Services Cost	\$ 171,851,285	\$ 377,871,900	2.8%	17.5%	87.7%
State Employee Health Services Cost	\$ 270,857,328	\$ 374,404,787	2.8%	7.6%	37.8%
State Employee Retirement Contributions	\$ 212,947,331	\$ 354,400,568	2.6%	10.9%	54.6%
DCF Board and Care	\$ 194,442,933	\$ 297,675,800	2.2%	9.0%	44.8%
DMR Community Residential Services	\$ 202,123,783	\$ 264,990,950	2.0%	5.6%	28.0%
All Major GF Accounts (51)	\$ 10,139,108,481	\$ 12,775,632,606	94.9%	4.7%	23.7%
All GF Accounts (750)	\$ 11,184,367,722	\$ 13,464,301,582	100.0%	3.8%	19.1%
	Actual FY 00	Est. FY 05			
Total GF Revenue	\$ 8,986,306,827	\$ 10,155,100,000		2.7%	13.4%
CT Personal Income	\$ 141,570,257,000	\$ 168,095,000,000		3.5%	17.6%
Inflation (CPI-U)	3.4%	3.5%		2.7%	16.1%

Sources of Data: OFA; U.S. BEA; U.S. BLS

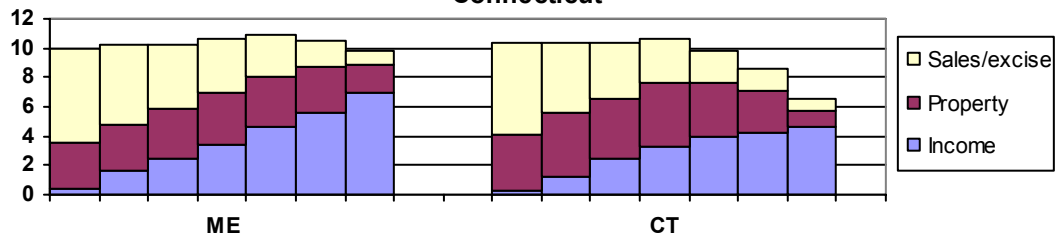
Appendix E: Tax Burden Comparison Among the Northeastern States

Figure E-1. Tax Burden Among Income Groups 2002: Mass. and Connecticut



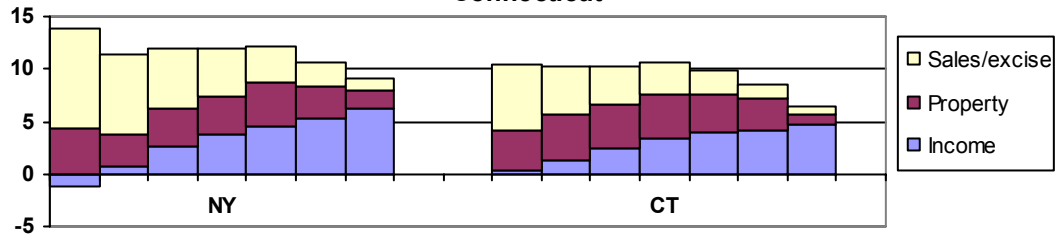
Source of Data: ITEP "Who Pays," January 2003

Figure E-2. Tax Burden Among Income Groups 2002: Maine and Connecticut



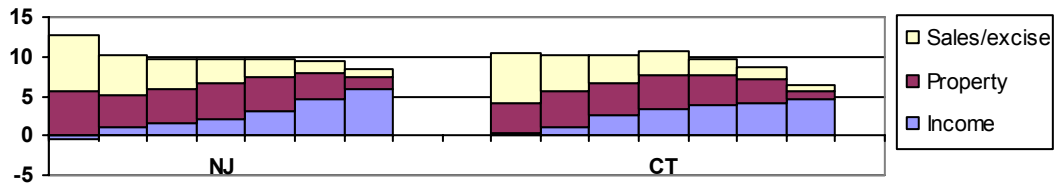
Source of Data: ITEP "Who Pays," January 2003

Figure E-3. Tax Burden Among Income Groups 2002: New York and Connecticut



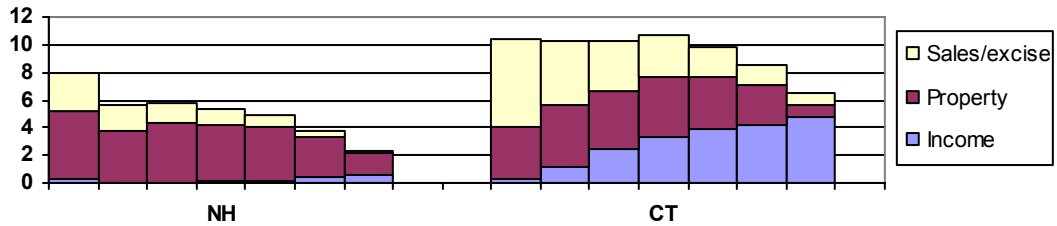
Source of Data: ITEP "Who Pays," January 2003

Figure E-4. Tax Burden Among Income Groups 2002: New Jersey and Connecticut



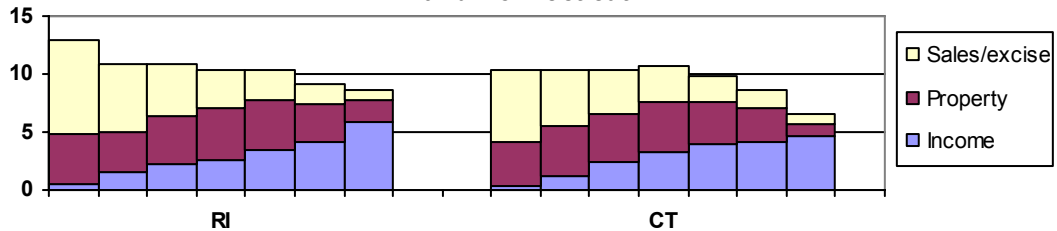
Source of Data: ITEP "Who Pays," January 2003

Figure E-5. Tax Burden Among Income Groups 2002: New Hampshire and Connecticut



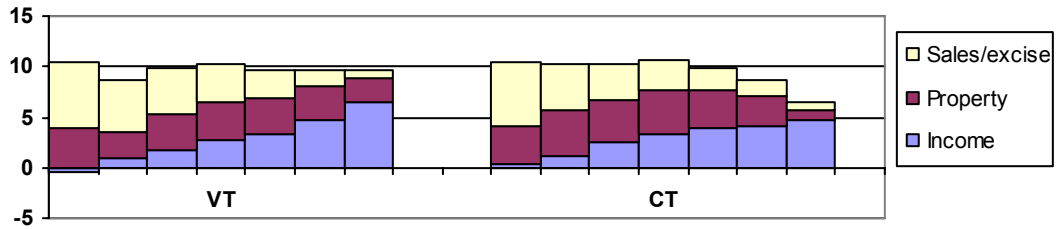
Source of Data: ITEP "Who Pays," January 2003

Figure E-6. Tax Burden Among Income Groups 2002: Rhode Island and Connecticut



Source of Data: ITEP "Who Pays," January 2003

Figure E-7. Tax Burden Among Income Groups 2002: Vermont and Connecticut



Source of Data: ITEP "Who Pays," January 2003

Appendix F. Motor Vehicle Property Tax at Statewide Median Rate and at Revenue Neutral Rate							
TOWN	NET TOTAL ASSESSED VALUE of MOTOR VEHICLES	MILL RATE	CURRENT TOTAL MOTOR VEHICLE TAX	NET TAX AT MEDIAN (approx. \$27.00 mills)	TAX LOSS /GAIN IF TAXED AT MEDIAN	NET TAX AT REVENUE NEUTRAL RATE (approx. \$29.45 mills)	TAX LOSS/GAIN IF TAXED AT REVENUE NEUTRAL RATE
Washington	\$36,359,881	11.0000	\$399,959	\$981,637	\$581,678	\$1,070,798	\$670,840
Greenwich	\$670,247,880	11.5100	\$7,714,553	\$18,095,218	\$10,380,665	\$19,738,800	\$12,024,247
Lyme	\$18,874,218	13.0000	\$245,365	\$509,562	\$264,198	\$555,846	\$310,481
Darien	\$209,324,213	13.0200	\$2,725,401	\$5,651,293	\$2,925,892	\$6,164,949	\$3,439,548
New Canaan	\$230,323,400	13.3890	\$3,083,800	\$6,218,225	\$3,134,425	\$6,783,410	\$3,699,610
Sharon	\$23,970,370	14.2000	\$340,379	\$647,147	\$306,768	\$705,968	\$365,588
Sherman	\$32,330,850	14.5000	\$468,797	\$872,862	\$404,064	\$952,198	\$483,400
Old Saybrook	\$83,032,142	14.6000	\$1,212,269	\$2,241,685	\$1,029,416	\$2,445,436	\$1,233,167
Salisbury	\$31,436,100	15.3000	\$480,972	\$848,706	\$367,733	\$925,846	\$444,874
Roxbury	\$25,850,189	15.4000	\$398,093	\$697,898	\$299,805	\$761,331	\$363,238
Essex	\$56,700,526	15.5000	\$878,858	\$1,530,789	\$651,931	\$1,669,926	\$791,067
Thompson	\$56,618,495	15.9100	\$900,800	\$1,528,575	\$627,775	\$1,667,510	\$766,709
Old Lyme	\$64,161,537	16.6000	\$1,065,082	\$1,732,220	\$667,139	\$1,889,665	\$824,583
Kent	\$21,755,907	16.9800	\$369,415	\$587,362	\$217,946	\$640,748	\$271,333
Pomfret	\$19,621,829	18.2200	\$357,510	\$529,746	\$172,236	\$577,896	\$220,386
Bridgewater	\$16,951,317	18.5000	\$313,599	\$457,648	\$144,049	\$499,245	\$185,645
Warren	\$7,905,370	18.7200	\$147,989	\$213,428	\$65,439	\$232,826	\$84,838
Waterford	\$136,199,290	18.8400	\$2,565,995	\$3,677,081	\$1,111,087	\$4,011,297	\$1,445,303
New Fairfield	\$101,444,767	19.0700	\$1,934,552	\$2,738,786	\$804,234	\$2,987,718	\$1,053,167
Brooklyn	\$43,958,575	19.9000	\$874,776	\$1,186,785	\$312,009	\$1,294,654	\$419,878
Morris	\$16,517,275	19.9000	\$328,694	\$445,930	\$117,236	\$486,461	\$157,768
Stonington	\$115,931,800	20.2200	\$2,344,141	\$3,129,904	\$785,763	\$3,414,386	\$1,070,245
Somers	\$63,632,220	20.2500	\$1,288,552	\$1,717,930	\$429,377	\$1,874,076	\$585,523
Canterbury	\$33,781,675	20.5000	\$692,524	\$912,031	\$219,507	\$994,927	\$302,403
Bethlehem	\$27,522,196	20.5600	\$565,856	\$743,039	\$177,182	\$810,575	\$244,718
Branford	\$199,530,637	20.9700	\$4,184,157	\$5,386,888	\$1,202,731	\$5,876,512	\$1,692,354
Lisbon	\$26,038,199	21.0000	\$546,802	\$702,974	\$156,172	\$766,869	\$220,066
Goshen	\$23,208,174	21.2000	\$492,013	\$626,570	\$134,556	\$683,520	\$191,506
Madison	\$140,980,080	21.2300	\$2,993,007	\$3,806,152	\$813,145	\$4,152,100	\$1,159,093
Westport	\$288,738,534	21.3000	\$6,150,131	\$7,795,305	\$1,645,174	\$8,503,834	\$2,353,703
Watertown	\$141,309,843	21.3500	\$3,016,965	\$3,815,055	\$798,090	\$4,161,812	\$1,144,847
Woodbury	\$80,317,184	21.4200	\$1,720,394	\$2,168,387	\$447,993	\$2,365,476	\$645,082
Westbrook	\$46,482,091	21.4300	\$996,111	\$1,254,914	\$258,803	\$1,368,976	\$372,864
Putnam	\$45,067,820	21.4500	\$966,705	\$1,216,732	\$250,027	\$1,327,323	\$360,618
Cornwall	\$13,695,840	21.8000	\$298,569	\$369,758	\$71,188	\$403,365	\$104,796
Mansfield	\$65,485,275	22.0100	\$1,441,331	\$1,767,958	\$326,627	\$1,928,651	\$487,320
Weston	\$112,810,727	22.0500	\$2,487,477	\$3,045,641	\$558,165	\$3,322,465	\$834,989
Chester	\$26,296,888	22.1200	\$581,687	\$709,958	\$128,271	\$774,487	\$192,800
Guilford	\$162,461,180	22.2700	\$3,618,010	\$4,386,094	\$768,084	\$4,784,754	\$1,166,744
Windsor Locks	\$149,397,584	22.4000	\$3,346,506	\$4,033,406	\$686,900	\$4,400,009	\$1,053,503

Appendix F. Motor Vehicle Property Tax at Statewide Median Rate and at Revenue Neutral Rate							
TOWN	NET TOTAL ASSESSED VALUE of MOTOR VEHICLES	MILL RATE	CURRENT TOTAL MOTOR VEHICLE TAX	NET TAX AT MEDIAN (approx. \$27.00 mills)	TAX LOSS /GAIN IF TAXED AT MEDIAN	NET TAX AT REVENUE NEUTRAL RATE (approx. \$29.45 mills)	TAX LOSS/GAIN IF TAXED AT REVENUE NEUTRAL RATE
Wilton	\$181,685,553	22.5500	\$4,097,009	\$4,905,110	\$808,101	\$5,350,944	\$1,253,935
Redding	\$86,334,680	22.7400	\$1,963,251	\$2,330,846	\$367,596	\$2,542,701	\$579,450
Litchfield	\$56,515,960	22.9000	\$1,294,215	\$1,525,807	\$231,591	\$1,664,490	\$370,274
Groton	\$188,622,787	22.9500	\$4,328,893	\$5,092,400	\$763,507	\$5,555,257	\$1,226,364
Danbury	\$441,367,645	23.0300	\$10,164,697	\$11,915,955	\$1,751,259	\$12,999,017	\$2,834,320
Franklin	\$15,674,470	23.1300	\$362,550	\$423,176	\$60,626	\$461,639	\$99,089
Ridgefield	\$223,539,593	23.4200	\$5,235,297	\$6,035,077	\$799,780	\$6,583,616	\$1,348,319
Union	\$5,322,440	23.4300	\$124,705	\$143,694	\$18,989	\$156,755	\$32,050
Bozrah	\$20,895,853	23.5000	\$491,053	\$564,142	\$73,090	\$615,418	\$124,365
Sprague	\$14,092,228	23.5000	\$331,167	\$380,459	\$49,292	\$415,040	\$83,872
Shelton	\$266,041,202	23.5900	\$6,275,912	\$7,182,527	\$906,615	\$7,835,359	\$1,559,447
Brookfield	\$129,659,590	23.9000	\$3,098,864	\$3,500,524	\$401,659	\$3,818,692	\$719,828
Southbury	\$138,334,213	23.9000	\$3,306,188	\$3,734,719	\$428,532	\$4,074,174	\$767,987
Monroe	\$146,849,368	24.0500	\$3,531,727	\$3,964,610	\$432,883	\$4,324,960	\$793,233
Avon	\$149,077,270	24.1600	\$3,601,707	\$4,024,758	\$423,051	\$4,390,576	\$788,869
Harwinton	\$40,305,400	24.2000	\$975,391	\$1,088,157	\$112,766	\$1,187,062	\$211,671
Lebanon	\$44,831,337	24.2000	\$1,084,918	\$1,210,347	\$125,429	\$1,320,358	\$235,440
Farmington	\$191,391,795	24.2700	\$4,645,079	\$5,167,157	\$522,079	\$5,636,809	\$991,730
North Canaan	\$7,833,142	24.4000	\$191,129	\$211,478	\$20,349	\$230,699	\$39,570
Suffield	\$88,629,390	24.4300	\$2,165,216	\$2,392,799	\$227,583	\$2,610,284	\$445,068
Fairfield	\$423,802,812	24.8000	\$10,510,310	\$11,441,744	\$931,434	\$12,481,703	\$1,971,394
Killingly	\$85,102,086	25.0000	\$2,127,552	\$2,297,569	\$170,017	\$2,506,399	\$378,847
Easton	\$71,844,023	25.1200	\$1,804,722	\$1,939,631	\$134,909	\$2,115,927	\$311,205
Norwalk	\$513,900,101	25.2100	\$12,955,422	\$13,874,172	\$918,751	\$15,135,220	\$2,179,798
Willington	\$35,055,420	25.5100	\$894,264	\$946,419	\$52,155	\$1,032,441	\$138,177
Preston	\$31,191,922	25.7000	\$801,632	\$842,113	\$40,481	\$918,654	\$117,022
Norfolk	\$13,536,286	25.8000	\$349,236	\$365,450	\$16,214	\$398,666	\$49,430
Rocky Hill	\$163,859,530	25.8000	\$4,227,576	\$4,423,847	\$196,271	\$4,825,938	\$598,362
Coventry	\$72,670,482	25.9200	\$1,883,619	\$1,961,943	\$78,324	\$2,140,268	\$256,649
Plainfield	\$76,486,725	25.9400	\$1,984,066	\$2,064,973	\$80,908	\$2,252,662	\$268,597
East Granby	\$41,885,546	26.0000	\$1,089,024	\$1,130,818	\$41,793	\$1,233,600	\$144,575
Woodstock	\$42,642,403	26.0000	\$1,108,702	\$1,151,251	\$42,549	\$1,255,890	\$147,188
Barkhamsted	\$24,660,600	26.1000	\$643,642	\$665,782	\$22,140	\$726,296	\$82,654
Newtown	\$202,889,529	26.1000	\$5,295,417	\$5,477,571	\$182,154	\$5,975,437	\$680,020
East Haddam	\$58,984,770	26.2800	\$1,550,120	\$1,592,459	\$42,339	\$1,737,200	\$187,081
Bethel	\$119,597,530	26.4800	\$3,166,943	\$3,228,870	\$61,928	\$3,522,348	\$355,405
Hartland	\$9,362,305	26.5000	\$248,101	\$252,762	\$4,661	\$275,736	\$27,634
New Hartford	\$43,699,300	26.5000	\$1,158,031	\$1,179,785	\$21,754	\$1,287,018	\$128,986
Wallingford	\$283,305,781	26.6000	\$7,535,934	\$7,648,633	\$112,699	\$8,343,830	\$807,896
Killingworth	\$46,048,899	26.6300	\$1,226,282	\$1,243,219	\$16,937	\$1,356,217	\$129,935

Appendix F. Motor Vehicle Property Tax at Statewide Median Rate and at Revenue Neutral Rate							
TOWN	NET TOTAL ASSESSED VALUE of MOTOR VEHICLES	MILL RATE	CURRENT TOTAL MOTOR VEHICLE TAX	NET TAX AT MEDIAN (approx. \$27.00 mills)	TAX LOSS /GAIN IF TAXED AT MEDIAN	NET TAX AT REVENUE NEUTRAL RATE (approx. \$29.45 mills)	TAX LOSS/GAIN IF TAXED AT REVENUE NEUTRAL RATE
Cheshire	\$202,445,169	26.6500	\$5,395,164	\$5,465,574	\$70,410	\$5,962,350	\$567,186
Norwich	\$165,441,230	26.7200	\$4,420,590	\$4,466,549	\$45,960	\$4,872,522	\$451,932
East Lyme	\$105,194,731	26.8410	\$2,823,532	\$2,840,026	\$16,495	\$3,098,161	\$274,629
Stratford	\$275,848,994	26.9800	\$7,442,406	\$7,447,316	\$4,910	\$8,124,215	\$681,809
East Windsor	\$76,113,086	26.9978	\$2,054,886	\$2,054,886	\$0	\$2,241,658	\$186,772
Burlington	\$62,246,252	27.0000	\$1,680,649	\$1,680,512	-\$137	\$1,833,256	\$152,608
New Milford	\$189,253,005	27.1100	\$5,130,649	\$5,109,415	-\$21,234	\$5,573,818	\$443,169
Bethany	\$38,401,690	27.1200	\$1,041,454	\$1,036,761	-\$4,693	\$1,130,994	\$89,540
Tolland	\$91,188,208	27.2200	\$2,482,143	\$2,461,881	-\$20,262	\$2,685,646	\$203,503
Oxford	\$82,830,499	27.6900	\$2,293,577	\$2,236,241	-\$57,335	\$2,439,497	\$145,921
Canton	\$68,321,120	27.8400	\$1,902,060	\$1,844,520	-\$57,540	\$2,012,172	\$110,112
Windham	\$84,148,040	27.8700	\$2,345,206	\$2,271,812	-\$73,394	\$2,478,301	\$133,095
Woodbridge	\$75,883,074	28.2200	\$2,141,420	\$2,048,676	-\$92,744	\$2,234,884	\$93,463
Deep River	\$27,483,966	28.2500	\$776,422	\$742,007	-\$34,415	\$809,449	\$33,027
Griswold	\$59,059,781	28.2500	\$1,668,439	\$1,594,484	-\$73,955	\$1,739,410	\$70,971
Berlin	\$139,540,655	28.4000	\$3,962,955	\$3,767,291	-\$195,664	\$4,109,706	\$146,752
Windsor	\$169,067,167	28.7300	\$4,857,300	\$4,564,442	-\$292,858	\$4,979,312	\$122,012
Montville	\$106,665,029	29.1000	\$3,103,952	\$2,879,721	-\$224,231	\$3,141,464	\$37,512
Hampton	\$11,477,350	29.2500	\$335,712	\$309,863	-\$25,849	\$338,027	\$2,315
Bolton	\$32,353,940	29.3000	\$947,970	\$873,485	-\$74,485	\$952,878	\$4,907
Southington	\$275,233,634	29.4300	\$8,100,126	\$7,430,703	-\$669,423	\$8,106,092	\$5,966
Canaan	\$7,400,130	29.5000	\$218,304	\$199,787	-\$18,517	\$217,946	-\$358
Cromwell	\$80,517,433	29.6000	\$2,383,316	\$2,173,794	-\$209,522	\$2,371,373	-\$11,943
Voluntown	\$12,242,980	29.6500	\$363,004	\$330,534	-\$32,471	\$360,576	-\$2,428
Columbia	\$38,230,219	29.8000	\$1,139,261	\$1,032,132	-\$107,129	\$1,125,944	-\$13,316
Middletown	\$233,752,390	29.8000	\$6,965,821	\$6,310,800	-\$655,021	\$6,884,400	-\$81,421
North Stonington	\$37,257,260	30.0000	\$1,117,718	\$1,005,864	-\$111,854	\$1,097,289	-\$20,429
Wethersfield	\$156,045,567	30.1900	\$4,711,016	\$4,212,887	-\$498,129	\$4,595,804	-\$115,212
Sterling	\$17,427,820	30.2500	\$527,192	\$470,513	-\$56,679	\$513,279	-\$13,913
Trumbull	\$246,673,403	30.4800	\$7,518,605	\$6,659,639	-\$858,966	\$7,264,945	-\$253,660
Marlborough	\$43,554,249	30.6400	\$1,334,502	\$1,175,869	-\$158,633	\$1,282,746	-\$51,757
North Branford	\$96,423,170	30.7000	\$2,960,191	\$2,603,213	-\$356,978	\$2,839,824	-\$120,367
Clinton	\$80,987,551	30.7900	\$2,493,607	\$2,186,486	-\$307,121	\$2,385,219	-\$108,388
East Hampton	\$76,615,783	30.8100	\$2,360,532	\$2,068,458	-\$292,075	\$2,256,463	-\$104,069
Middlebury	\$53,420,963	30.8200	\$1,646,434	\$1,442,248	-\$204,186	\$1,573,337	-\$73,097
Ansonia	\$85,186,411	30.8600	\$2,628,853	\$2,299,846	-\$329,007	\$2,508,883	-\$119,970
Haddam	\$53,921,990	31.0000	\$1,671,582	\$1,455,775	-\$215,807	\$1,588,093	-\$83,489
Bloomfield	\$117,561,688	31.0300	\$3,647,939	\$3,173,907	-\$474,032	\$3,462,389	-\$185,550
Eastford	\$8,858,207	31.3000	\$277,262	\$239,152	-\$38,110	\$260,889	-\$16,373
Ashford	\$26,114,960	31.6000	\$825,233	\$705,046	-\$120,186	\$769,129	-\$56,103

Appendix F. Motor Vehicle Property Tax at Statewide Median Rate and at Revenue Neutral Rate							
TOWN	NET TOTAL ASSESSED VALUE of MOTOR VEHICLES	MILL RATE	CURRENT TOTAL MOTOR VEHICLE TAX	NET TAX AT MEDIAN (approx. \$27.00 mills)	TAX LOSS /GAIN IF TAXED AT MEDIAN	NET TAX AT REVENUE NEUTRAL RATE (approx. \$29.45 mills)	TAX LOSS/GAIN IF TAXED AT REVENUE NEUTRAL RATE
Wolcott	\$101,757,050	31.6400	\$3,219,593	\$2,747,216	-\$472,377	\$2,996,916	-\$222,677
Colchester	\$95,028,240	31.7500	\$3,017,147	\$2,565,553	-\$451,593	\$2,798,741	-\$218,406
Orange	\$109,206,207	31.9000	\$3,483,678	\$2,948,327	-\$535,351	\$3,216,306	-\$267,372
South Windsor	\$179,105,971	31.9500	\$5,722,436	\$4,835,467	-\$886,969	\$5,274,971	-\$447,465
Seymour	\$95,171,475	32.0400	\$3,049,294	\$2,569,420	-\$479,874	\$2,802,959	-\$246,335
Glastonbury	\$242,784,040	32.1000	\$7,793,368	\$6,554,635	-\$1,238,733	\$7,150,397	-\$642,971
North Haven	\$186,113,370	32.1700	\$5,987,267	\$5,024,652	-\$962,616	\$5,481,351	-\$505,916
Milford	\$315,458,511	32.1800	\$10,151,455	\$8,516,686	-\$1,634,769	\$9,290,782	-\$860,673
Middlefield	\$29,237,554	32.2200	\$942,034	\$789,350	-\$152,684	\$861,095	-\$80,939
Salem	\$25,068,935	32.4000	\$812,233	\$676,806	-\$135,427	\$738,322	-\$73,911
Torrington	\$179,969,220	32.7600	\$5,895,792	\$4,858,773	-\$1,037,019	\$5,300,395	-\$595,396
Scotland	\$8,392,373	32.8000	\$275,270	\$226,576	-\$48,694	\$247,169	-\$28,100
Winchester	\$58,394,695	32.9800	\$1,925,857	\$1,576,528	-\$349,329	\$1,719,822	-\$206,035
Chaplin	\$11,323,955	33.0000	\$373,691	\$305,722	-\$67,969	\$333,509	-\$40,181
Prospect	\$61,277,490	33.1500	\$2,031,349	\$1,654,357	-\$376,991	\$1,804,725	-\$226,624
Ledyard	\$96,374,800	33.1700	\$3,196,752	\$2,601,908	-\$594,845	\$2,838,399	-\$358,353
Hebron	\$59,155,479	33.2400	\$1,966,328	\$1,597,068	-\$369,260	\$1,742,228	-\$224,100
Bristol	\$318,065,880	33.3300	\$10,601,136	\$8,587,079	-\$2,014,057	\$9,367,573	-\$1,233,562
Granby	\$72,316,384	33.4100	\$2,416,090	\$1,952,383	-\$463,707	\$2,129,839	-\$286,252
Beacon Falls	\$35,407,140	33.2500	\$1,177,287	\$955,915	-\$221,373	\$1,042,800	-\$134,488
Ellington	\$89,743,225	33.6000	\$3,015,372	\$2,422,870	-\$592,503	\$2,643,088	-\$372,284
New London	\$94,093,921	33.7700	\$3,177,552	\$2,540,329	-\$637,223	\$2,771,224	-\$406,328
Andover	\$19,752,871	34.5000	\$681,474	\$533,284	-\$148,190	\$581,755	-\$99,719
Plainville	\$116,524,300	34.5000	\$4,020,088	\$3,145,900	-\$874,189	\$3,431,836	-\$588,252
Enfield	\$220,719,710	35.2000	\$7,769,334	\$5,958,947	-\$1,810,387	\$6,500,566	-\$1,268,768
Simsbury	\$163,818,732	35.2000	\$5,766,419	\$4,422,745	-\$1,343,674	\$4,824,736	-\$941,683
Stamford	\$797,435,068	35.6200	\$28,404,637	\$21,528,992	-\$6,875,645	\$23,485,800	-\$4,918,837
Vernon	\$145,019,287	35.7900	\$5,190,240	\$3,915,202	-\$1,275,039	\$4,271,061	-\$919,179
Stafford	\$73,896,087	36.3700	\$2,687,601	\$1,995,032	-\$692,569	\$2,176,364	-\$511,237
Newington	\$188,730,900	36.4300	\$6,875,467	\$5,095,319	-\$1,780,148	\$5,558,441	-\$1,317,025
Naugatuck	\$143,763,127	37.1000	\$5,333,612	\$3,881,288	-\$1,452,324	\$4,234,065	-\$1,099,547
Portland	\$58,281,180	37.2400	\$2,170,391	\$1,573,464	-\$596,928	\$1,716,478	-\$453,913
Colebrook	\$7,006,881	37.6000	\$263,459	\$189,170	-\$74,288	\$206,364	-\$57,094
Derby	\$55,878,026	37.7000	\$2,106,602	\$1,508,584	-\$598,018	\$1,645,702	-\$460,900
East Haven	\$140,167,080	37.7500	\$5,291,307	\$3,784,203	-\$1,507,104	\$4,128,155	-\$1,163,152
Durham	\$45,985,160	38.0000	\$1,747,436	\$1,241,498	-\$505,938	\$1,354,340	-\$393,096
Manchester	\$293,277,565	38.0700	\$11,165,077	\$7,917,849	-\$3,247,228	\$8,637,516	-\$2,527,561
Thomaston	\$49,135,680	38.6600	\$1,899,585	\$1,326,555	-\$573,030	\$1,447,128	-\$452,457
Bridgeport-	\$347,632,402	40.3200	\$14,016,538	\$9,385,310	-\$4,631,228	\$10,238,357	-\$3,778,181
Meriden	\$249,982,410	40.3400	\$10,084,290	\$6,748,975	-\$3,335,315	\$7,362,401	-\$2,721,889
Plymouth	\$70,459,155	40.7000	\$2,867,688	\$1,902,242	-\$965,445	\$2,075,140	-\$792,547
West Haven	\$214,412,530	41.0900	\$8,810,211	\$5,788,667	-\$3,021,544	\$6,314,808	-\$2,495,402
East	\$230,644,195	41.3400	\$9,534,831	\$6,226,886	-\$3,307,945	\$6,792,858	-\$2,741,973

Appendix F. Motor Vehicle Property Tax at Statewide Median Rate and at Revenue Neutral Rate							
TOWN	NET TOTAL ASSESSED VALUE of MOTOR VEHICLES	MILL RATE	CURRENT TOTAL MOTOR VEHICLE TAX	NET TAX AT MEDIAN (approx. \$27.00 mills)	TAX LOSS /GAIN IF TAXED AT MEDIAN	NET TAX AT REVENUE NEUTRAL RATE (approx. \$29.45 mills)	TAX LOSS/GAIN IF TAXED AT REVENUE NEUTRAL RATE
Hartford							
New Haven	\$279,390,551	42.5300	\$11,882,480	\$7,542,930	-\$4,339,550	\$8,228,520	-\$3,653,960
Hamden	\$279,161,577	43.2400	\$12,070,947	\$7,536,748	-\$4,534,198	\$8,221,776	-\$3,849,170
West Hartford	\$353,361,790	44.0700	\$15,572,654	\$9,539,991	-\$6,032,663	\$10,407,097	-\$5,165,557
New Britain	\$227,006,024	45.8900	\$10,417,306	\$6,128,663	-\$4,288,643	\$6,685,708	-\$3,731,598
Waterbury	\$320,405,328	53.9668	\$17,291,250	\$8,650,239	-\$8,641,011	\$9,436,474	-\$7,854,776
Hartford	\$248,509,040	60.8200	\$15,114,320	\$6,709,197	-\$8,405,122	\$7,319,008	-\$7,795,312
	\$20,077,993,409		\$591,330,567	\$542,061,650		\$591,329,351	
Note: Does not include special taxing districts Source: OPM and LPR&IC calculations							

Appendix G: Taxation of Services

Business Services	CT	ME	MA	NH	NJ	NY	RI	VT
Sales of advertising time or space:								
Billboards	E	E	E		6	E	E	E
Radio & television, national advertising	E	E	E		E	E	E	E
Radio & television, local advertising	E	E	E		E	E	E	E
Newspaper	E	E	E		E	E	E	E
Magazine	E	E	E		E	E	E	E
Advertising agency fees (not ad placement)	6	5	E		E	E	E	E
Armored car services	6	E	E		E	4.25	E	E
Bail bond fees	E	E	E		E	E	E	E
Check & debt collection	E	E	E		E	E	E	E
Commercial art and graphic design.	6	5	E		6	E	7	6
Commercial linen supply	E	E	E		E	E	E	E
Credit information, credit bureaus	6	E	E		E	E	E	E
Employment agencies	6	E	E		E	E	E	E
Interior design and decorating	E	E	E		E	4.25	E	E
Maintenance and janitorial services	6	E	E		6	4.25	E	E
Lobbying and consulting	6	E	E		E	E	E	E
Marketing	E	E	E		E	E	E	E
Packing and crating	E	E	E		E	E	E	E
Exterminating (includes termite services)	6	E	E		6	4.25	E	E
Photocopying services	6	5	5		6	4.25	7	6
Photo finishing	6	5	5		6	4.25	7	6
Printing	6	5	5		6	4.25	7	6
Private investigation (detective) services	6	E	E		E	4.25	E	E
Process server fees	E	E	E		E	E	E	E
Public relations, management consulting	6	E	E		E	E	E	E
Secretarial and court reporting services	6	E	E		E	E	E	E
Security services	6	E	E		E	4.25	E	E
Sign construction and installation	6	5	5		E	4.25	7	6
Telemarketing services on contract	E	E	E		E	E	E	E
Telephone answering service	6	E	E		6	4.25	7	E
Temporary help agencies	6	E	E		E	E	E	E
Test laboratories (excluding medical)	E	E	E		E	E	E	E
Tire recapping and repairing	6	E	E		6	4.25	E	E
Window cleaning	6	E	E		6	4.25	E	E
Total	20	6	4	0	10	13	6	5

Computer Services	CT	ME	MA	NH	NJ	NY	RI	VT
Software - package or canned program	6	5	5		6	4.25	7	6
Software - modifications to canned program	6	E	E		E	E	7	6
Software - custom programs - material	1	E	E		E	E	7	6
Software - custom programs - professional serv.	1	E	E		E	E	E	E
Internet Service Providers-Dialup	E	E	E	7	E	E	E	E
Internet Service Providers-DSL or other broadband	E	E	E	7	E	E	E	E
Information services	1	E	E		E	4.25	E	E
Data processing services	1	E	E		E	E	E	E
Mainframe computer access and processing serv.	1	E	E		E	E	7	E
Total	6	0	0	2	0	1	3	2

Personal Services	CT	ME	MA	NH	NJ	NY	RI	VT
Barber shops and beauty parlors	E	E	E		E	E ⁴	E	E
Carpet and upholstery cleaning	6	E	E		E	4.25	E	E
Dating services	6	E	E		E	E	E	E
Debt counseling	6	E	E		E	E	E	E
Diaper service	E	E	E		E	E	E	E
Income from funeral services	E ¹	E	E		E	E	E	E
Fishing and hunting guide services	E	E	E		E	E	E	E
Garment services (altering & repairing)	6	E	E		E	E	E	E
Gift and package wrapping service	E	E	E		E	E	E	E
Health clubs, tanning parlors, reducing salons	6	E	E		E	E ⁴	E	6
Laundry and dry cleaning services, coin-op	E	E	E		E	E	E	E
Laundry and dry cleaning services, non-coin op	E	E	E		E	E	E	E
Massage services	6 ²	E	E		E	E ⁴	E	E
900 Number services	6	5	5	7	6	9.25	7	E
Personal instruction (dance, golf, tennis, etc.)	E	E	E		E	E	E	E
Shoe repair	E	E	E		E	E	E	E
Swimming pool cleaning & maintenance	6	E	E		6	4.25	E	E
Tax return preparation	1 ³	E	E		E	E	E	E
Tuxedo rental	6	E	E		E	4.25	E	6
Water softening and conditioning	E	E	E		E	E	E	E
Total	10	1	1	1	2	4	1	2

1) Taxable after \$2,500.

2) Services by a licensed massage therapist are tax exempt.

3) If done electronically it is subject to a 1% sales tax for the data processing.

4) Subject to NYC local tax.

Utility Service - Industrial Use	CT	ME	MA	NH	NJ	NY	RI	VT
Intrastate telephone & telegraph	6	5	5	7 ⁸	6	4.25	7	E
Interstate telephone & telegraph	6	E	5	7 ⁸	6	E	7	E
Cellular telephone services	6	5	5	7 ⁹	6	4.25	7	E
Electricity	6 ¹	5 ³	5 ⁶		6	E ¹⁰	7 ¹³	6 ¹⁴
Water	E ¹	5 ⁴	E		E	E	7 ¹³	E
Natural gas	6 ¹	5 ³	5 ⁶		6	E ¹⁰	7 ¹³	6 ¹⁴
Other fuel (including heating oil)	6	5 ³	5 ⁶		E	E ¹⁰	7 ¹³	6 ¹⁴
Sewer and refuse, industrial	6 ²	E	E		E	E	E	E
- Residential Use								
Intrastate telephone & telegraph	6	5	5 ⁷	7 ⁸	6	4.25	7	6
Interstate telephone & telegraph	6	E	5	7 ⁸	6	E	7	6
Cellular telephone services	6	5	5	7 ⁹	6	4.25	7	6
Electricity	E	5 ⁵	E		6	E ¹¹	E	E
Water	E	E	E		E	E ¹²	E	E
Natural gas	E	E	E		6	E ¹¹	E	E
Other fuel (including heating oil)	E	E	E		E	E ¹¹	E	E
Sewer and refuse, residential	E	E	E		E	E	E	E
Total	10	9	9	6	10	4	10	6

1. Exempt for agriculture, fabrication and manufacturing when not less than 75% consumed for production, fabrication or manufacturing. Otherwise, electricity is taxable if over \$150 per month.
2. Sewer assessments not taxable.
3. 5% of sale price of fuel and electricity used at a manufacturing facility is taxable. Remaining 95% is exempt.
4. Exempt if ingredient or component part of, or consumed or destroyed or loses its identity directly and primarily in production of, tangible personal property.
5. First 750 KWH per month of residential service is exempt.
6. Uses for industrial production of tangible personal property or heating of industrial plants exempt, if 75% or more of the fuel is used for manufacturing. Exemption certificate required.
7. An exemption for residential telecommunications services billed on a recurring basis or message unit charges is allowed, up to \$30 a month.
8. No sales tax; taxed under communications services tax. Inter- and intrastate calls taxed. The present rate is 7%.
9. Cellular telephones are taxed under communications tax.
10. Taxable if not used directly and exclusively in production.
11. Subject to some local taxes.
12. Taxable if not delivered through pipes or mains
13. Direct use or consumption in manufacturing exempt.
14. Agricultural and manufacturing use exempt.

Source: Federation of Tax Administrators, Sales Taxation of Services, 2004. Available at <http://www.taxadmin.org/fta/pub/services/services04.html> , download date 9/15/05.

Appendix H: Minnesota Property Tax Comparison

The Minnesota Taxpayers Association (MTA) in cooperation with the National Taxpayers Conference prepared a study that compared the relative property tax burden for four types of property – residential, commercial, industrial and apartments – for the largest urban area and a typical rural city in each state and Washington DC.²⁶ (Four other cities were added to the analysis, for a total of 55 cities, because the largest cities in certain states were not considered typical.)

Urban area. Bridgeport is the representative city for Connecticut because it is the state's largest city. The study found the property tax burden in Connecticut ranked in the top 15 for all classes of property. Connecticut's property tax burden for commercial property was the same as residential but industrial property was estimated to be lower than all other classes of property. The tables below illustrate how Connecticut ranks among other states as measured by the estimated property tax burdens for three classes of property.

Table H-1. Urban Residential Property Tax on \$300,000 Valued Property – 2004				
Rank	State	City	Tax	Effective Tax Rate
1	Michigan	Detroit	\$9,605	3.202%
2	Connecticut	Bridgeport	\$8,188	2.729%
3	Wisconsin	Milwaukee	\$7,510	2.503%
4	Texas	Houston	\$6,942	2.314%
5	Florida	Miami-Dade	\$6,791	2.264%
	<i>Average</i>		<i>\$4,443</i>	<i>1.481%</i>
55	Hawaii	Honolulu	\$965	0.322%
54	Colorado	Denver	\$1,532	0.511%
53	Massachusetts	Boston	\$1,661	0.554%
52	Wyoming	Cheyenne	\$1,995	0.665%
51	Alabama	Birmingham	\$2,024	0.675%
Source: Minnesota Taxpayers Assoc. 2005				

Residential - Connecticut's 2004 property tax of \$8,188 on a \$300,000 home was nearly 85% above the U.S. average, as shown in Table H-1. Connecticut's effective tax rate of 2.73% ranked second highest in the country, and ranked first among the New England States.²⁷ The residential property tax in Boston, Massachusetts was ranked third lowest. Connecticut was similarly ranked for residential property valued at \$70,000 and \$150,000.

Commercial – Table H-2 shows Connecticut's property tax on commercial property valued at \$1.2 million (including fixtures or personal property) ranked 13th highest among the states and the District of Columbia, with an estimated \$32,752 in property taxes resulting in an effective property tax rate of 2.73%. Connecticut was 33.3% higher than the U.S. average and was third in New England, after Rhode Island and Massachusetts.

²⁶ Minnesota Taxpayers Association and National Taxpayers Conference. "50-State Property Tax Comparison Study: Payable Year 2004." St. Paul, Minnesota, January 2005.

²⁷ The effective tax rate is the total tax divided by the total value of property.

Table H-2. Urban Commercial Property Tax on \$1.2 Million Valued Property – 2004				
Rank	State	City	Tax	Effective Tax Rate
1	Michigan	Detroit	\$48,247	4.021%
2	New York	New York City	\$47,029	3.919%
3	Iowa	Des Moines	\$42,546	3.546%
4	Rhode Island	Providence	\$42,118	3.510%
5	Illinois	Chicago	\$38,911	3.243%
13	Connecticut	Bridgeport	\$32,752	2.729%
	<i>Average</i>		<i>\$24,562</i>	<i>2.047%</i>
55	Wyoming	Cheyenne	\$798	0.665%
54	Hawaii	Honolulu	\$10,630	0.886%
53	Delaware	Wilmington	\$10,970	0.914%
52	Kentucky	Lexington-Fayette	\$11,258	0.938%
51	Washington	Seattle	\$11,810	0.984%
Note: Includes values of \$1,000,000 Land and Building, \$200,000 Fixtures				
Source: Minnesota Taxpayers Assoc. 2005				

Industrial – As shown on Table H-3, Connecticut’s property tax on industrial property (includes machinery, equipment and fixtures) valued at a total of \$2,500,000 ranked 9th highest in the nation, as \$51,857 in net property taxes resulted in an effective property tax rate of 2.07% - lower than residential and commercial property. Connecticut was 36.9% higher than the U.S. average and second highest in New England, after Rhode Island. Boston, Massachusetts was 30th and Manchester, New Hampshire was 51st out of the 55 cites surveyed.

It is important to note exemptions are included in the tax calculations but credits generally are not. Thus, in the case of industrial property in Connecticut, the value of inventory is not taxed as it is exempt, while the credit for machinery and equipment is not included. The inclusion of this credit could make Connecticut appear more competitive.

Table H-3. Urban Industrial Property Tax on \$2.5 Million Valued Property –2004				
Rank	State	City	Tax	Effective Tax Rate
1	South Carolina	Columbia	\$89,085	3.563%
2	Michigan	Detroit	\$78,410	3.136%
3	Texas	Houston	\$74,065	2.963%
4	Kansas	Wichita	\$73,151	2.926%
5	Arizona	Phoenix	\$63,199	2.528%
9	Connecticut	Bridgeport	\$51,857	2.074%
	<i>Average</i>		<i>\$32,722</i>	<i>1.527%</i>
55	Hawaii	Honolulu	\$10,630	0.425%
54	Delaware	Wilmington	\$10,970	0.439%
53	Wyoming	Cheyenne	\$15,925	0.612%
52	Kentucky	Lexington-Fayette	\$16,133	0.645%
51	New Hampshire	Manchester	\$17,186	0.687%
Note: Includes values of \$1,000,000 Land and Building, \$750,000 Machinery and Equipment, \$600,000 Inventories, \$150,000 Fixtures				
Source: Minnesota Taxpayers Assoc. 2005				

Rural area. The MTA selected Windham as the “typical” rural city for Connecticut. Table H-4 compares that city to other similar cites in the nation. In this comparison, Connecticut fares somewhat better across property types than the city of Bridgeport does to its national counterparts.

The residential and industrial property tax burdens are ranked 17th among 50 municipalities, and the property tax burden is only about 9 percent above the national average for both those classifications. The commercial property tax burden is in the middle of the rankings and about 5 percent *below* the national average.

Table H-4. “Rural” Property Tax Comparison: Residential, Commercial, Industrial – 2004					
Rank	Property Type	Tax in CT	Effective Tax Rate	U.S. Average	Effective Tax Rate
17	Residential (\$300,000 value)	\$4,409	1.470%	\$4,055	1.352%
24	Commercial (\$1.2 million value)	\$18,810	1.567%	\$19,722	1.643%
17	Industrial (\$2.5 million value)	\$33,211	1.328%	\$30,365	1.215%
Note: Commercial property includes values of \$1,000,000 Land and Building, \$200,000 Fixtures and Industrial property includes values of \$1,000,000 Land and Building, \$750,000 Machinery and Equipment, \$600,000 Inventories, \$150,000 Fixtures Source: Minnesota Taxpayers Assoc. 2005					

Appendix I: Corporate Credit Usage by Industry							
NAICS Group	Number of Returns	% of Total Returns	Number of Credit Claimants	% of Total Claimants	Claimants as % of Total Returns	Total Value of Credit Claimed	% of Total
Manufacturing	4,534	10.24%	1,098	19.17%	24%	\$28,131,005	30.22%
Utilities	127	0.29%	16	0.28%	13%	\$14,334,780	15.40%
Retail Trade	4,108	9.28%	602	10.51%	15%	\$12,233,165	13.14%
Management of Companies and Enterprises	856	1.93%	107	1.87%	13%	\$11,877,164	12.76%
Information	1,148	2.59%	114	1.99%	10%	\$8,925,100	9.59%
Professional, Scientific and Tech Services	6,249	14.11%	896	15.65%	14%	\$4,965,462	5.33%
Finance and Insurance	3,056	6.90%	286	4.99%	9%	\$3,227,238	3.47%
Wholesale Trade	3,108	7.02%	443	7.74%	14%	\$2,492,426	2.68%
Administrative and Support Services	1,511	3.41%	130	2.27%	9%	\$1,569,453	1.69%
Not Yet Assigned	1,461	3.30%	29	0.51%	2%	\$1,189,434	1.28%
Transporting and Warehousing	997	2.25%	88	1.54%	9%	\$1,060,867	1.14%
Education, Health Care and Social Assistance	2,412	5.45%	757	13.22%	31%	\$975,094	1.05%
Construction	4,469	10.09%	588	10.27%	13%	\$484,045	0.52%
Other Services	3,755	8.48%	236	4.12%	6%	\$450,173	0.48%
Real Estate and Rental and Leasing	4,417	9.98%	140	2.44%	3%	\$314,404	0.34%
Arts, Entertainment, and Recreation	571	1.29%	46	0.80%	8%	\$303,936	0.33%
Agriculture, Forestry, Fishing and Hunting	165	0.37%	31	0.54%	19%	\$289,542	0.31%
Accommodation and Food Services	1,261	2.85%	111	1.94%	9%	\$211,071	0.23%
Mining	72	0.16%	9	0.16%	13%	\$61,806	0.07%
Total	44,277	100.00%	5,727	100.00%	13%	\$93,096,165	100.00%
Source: DRS and LPR&IC calculations							

Appendix J. DRS ITAS Project: Summary and Current Status (12/05)		
<i>PHASE I (A AND B): Business Taxes</i>	Description/Status	Scheduled Time Frame
Integrate automated administration of 40+ business taxes (sales and use, all excise, corporate income, etc.) with a single database and sharing of common functions including: <ul style="list-style-type: none"> a) Registration b) Return processing c) Taxpayer accounting d) Revenue accounting 	<p>System in place for all business taxes</p> <ul style="list-style-type: none"> • 200 desktop computers replaced with current technology • Registration in place for all business taxes • Return processing in place for all business taxes and supporting workflow capabilities also implemented • Taxpayer accounting in place for all business taxes • Revenue accounting (general ledger; interface with Core-CT) in place for all business taxes as well as Personal Income Tax • Real-time processing and immediate updating of taxpayer information available? • <i>On-line help system in development</i> • <i>Tool to develop/revise forms be available</i> • <i>Initial workflow and case management capabilities be available</i> <p>Legacy computer systems (MBDB business tax and WANG financial) for business taxes registration and processing and for agency revenue accounting retired</p>	Operational Mid-2005 (Phase A Jan. 2004: Phase B June 2005)
Start data warehouse	Initial research support and discovery functions in place with data model capability	Est. Jan. 2006
Develop new taxpayer identification system and single location for all taxpayer information	Taxpayer identification system implemented; consolidated taxpayer information system started	Est. Dec. 2005-Jan 2006

<i>PHASE 2: Personal Income Tax (PIT)</i>	Description/Status	Scheduled Time Frame
Add PIT to system so single database for all taxes (business and PIT) and shared common functions including: a) Registration b) Return processing; c) Taxpayer accounting d) Revenue accounting (note: implemented for PIT in Phase 1)	One system with above administrative functions will be in place for all taxes plus: <ul style="list-style-type: none"> • More timely PIT return processing (not as dependent on batching) • Another 200 desktop computers replaced with current technology Support will be provided for knowledge transfer to state information technology staff Legacy computer system for PIT administration (ITRP) will be retired	Est. July 2006
Expand data warehouse to include PIT	PIT data will be directly incorporated from ITAS	Est. July 2006
Expand reporting, case management, and workflow capabilities to include PIT	PIT data will be included in these system capabilities	Est. July 2006
<i>PHASE 3: Internal Management</i>	Description/Status	Scheduled Time Frame
Integrate/automate auditing functions	On-line audit capability will be available as well as electronic audit selection, case tracking, and an auditor's "workbench" (secure field access via laptop to all taxpayer information)	Est. Jan. 2006
Automate legal and appellate processes	Staff will be able to track, adjust, and transfer cases electronically throughout appeals/legal process	Est. Jan. 2006
Enhance data warehouse	Improved support will be available for impact analysis, audit selection, compliance program performance, and source trend analysis	Est. Jan. 2006
Expand case management function	Complete history of all taxpayer interactions with DRS will be available electronically	Est. Jan. 2006
Expand workflow function	Re audit cases, system will electronically generate correspondence, include notes and reminders, and assign and transfer cases	Est. Jan. 2006

<i>PHASE 4: Customer Service and Internal Management</i>	Description/Status	Scheduled Time Frame
Implement electronic customer service system integrated with ITAS	Electronic “self-service” system will be available to taxpayers allowing: <ul style="list-style-type: none"> • Automated access to transaction history and detail (payments, account balance, refund status, etc.) • Ability to register, change address, close account, etc. • Expanded filing and payment options • Secure “mailbox” communication with agency to exchange taxpayer specific information and documents 	Est. Sept. 2006
Enhance revenue collection and enforcement (C&E)	C&E system will be fully automated and integrated with ITAS (share all data), supporting <ul style="list-style-type: none"> • C&E case assignment, transfer and tracking and case processing through entire liability collection phase • Full C&E workflow and case management capabilities (correspondence generation, etc.) Legacy C&E computer system (CACS) will be retired	Est. Sept. 2006
Integrate image retrieval into system	ITAS users will be able to navigate tax account and transaction data and instantaneously view related tax return images, facilitating problem resolution	Est. Sept. 2006
Implement knowledge base function	Public users will be able to access the agency website to submit tax questions and search on-line for tax information	Est. Sept. 2006